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Civil and Common Law Approaches to Contract interpretation: a comparison – and do good faith obligations make any difference?

Paper for the Session on 11 October 2017, 09:30 to 12:30
(Jean-Pierre van Eijck & Douglas Oles, co-chairs)

Arbitrators and courts are fond of saying that when they interpret a contract, they prefer not to look beyond the "four corners" of the written agreement. In complex agreements for construction, design, and supply on building and infrastructure projects, however, it is often necessary to look beyond the parties' written agreements to resolve disputes. Contracts cannot anticipate every possible issue, and it is not unusual for a project to be impacted by unforeseen conditions or events. Moreover, there are some types of one-sided clauses that will not be enforced, even if they are written very clearly.

When courts and arbitrators interpret commercial agreements, the selection of governing law can have significant consequences. The rules for legal interpretation often vary from one country to another, and in some cases they vary between individual states or provinces inside a single country. Approaches to contract interpretation may also vary between Common Law countries and those whose legal system is based on a Civil Law tradition.

This paper will consider certain types of risk-shifting clauses that can be found in construction industry agreements, although the examples in this paper should not be viewed as "standard". The authors offer comments on each of these provisions in the context of the jurisdictions where they concentrate their legal practice.

The authors will concentrate their comments on the following jurisdictions:

Australia - Matthew Bell & Wayne Jocic
Chile - Jorge Allende
England – Robert Fenwick Elliott & Jennie Wild
Finland & Sweden - Tuomas Lehtinen and Anette Kavaleff & Alexia Kavaleff (Sweden)
Netherlands - Jean-Pierre van Eijck
United States - Douglas Oles

[The following sample clauses are simplified to facilitate discussion. They are not intended or recommended for use in any contract, and are not recommended by the authors.]

CLAUSE 1 – "NO DAMAGE FOR FORCE MAJEURE DELAY":

Sample: If the Project is materially delayed by an unforeseen Force Majeure event that is outside the control of either party, the Contract Time shall be extended, but neither party shall be entitled to monetary compensation from the other on account of the delay.

Comments from Common Law Jurisdictions:

Australia: The common law in Australian jurisdictions takes a restrictive view, along the lines of England, to events which might render a contract frustrated. Australian standard forms tend not to deal with *force majeure* as a separate concept (by contrast, for example, with the FIDIC contracts, which are relatively rarely used in Australia outside of engineering projects), but the more widely-used consensus forms allow the contractor an extension of time (sometimes, with a right to recover its cost, profit or both) for *force majeure*-type events.

For example, under the design and construct form, AS4300-1995 (which was found in a 2014 survey by Melbourne Law School and the Society of Construction Law Australia to be the most commonly-used form in Australia: John Sharkey et al, *Standard Forms of Contract in the Australian Construction Industry* (June 2014), available at http://law.unimelb.edu.au/news/MLS/forms-of-contract-in-the-construction-industry), the Contractor is entitled to an extension of time for Practical Completion for the following events potentially in the nature of *force majeure* which cause delay to Practical Completion (see clauses 16, 34.1, 35.5 and 40.5):

- inclement weather occurring on or before the Date for Practical Completion which is beyond the reasonable control of the Contractor and causes delay to Practical Completion;
- a direction to suspend the work under the Contract by the Superintendent (which may be 'for the protection or safety of any person or property');
- rectification of certain 'Excepted Risks', including contamination by radioactivity not caused by the Contractor; and
- Latent Conditions (which is widely defined in respect of physical conditions at the site and its surroundings, but excludes weather conditions).

Under these provisions, the Contractor may be entitled to recover its additional costs of suspension, but not for inclement weather alone. The Contractor is entitled to additional payment valued by way of a Variation (which may include profit) for rectification of Excepted Risks and Latent Conditions.

A range of approaches is manifest in other standard forms and in negotiated project forms, with the starting point from a legal risk allocation point of view being that reflected in the PC-1 form (see, primarily, clauses 5.3 and 10). There, the default approach is that the Contractor is entitled only to an extension of time (and not delay costs, unless caused by a breach of contract) and only for 'acts of prevention' – in other words, there is no entitlement for 'neutral' events of delay in the nature of *force majeure*, unless they are 'Excepted Risks' of the type referred to above (in which case they will be valued as a variation) or the optional latent conditions provision is included (in which case there is a limited right to additional cost and time).

England: The expression "force majeure" has no exact meaning in English law, and accordingly where the parties wish to include a force majeure clause in a contract, they typically define what they mean by it; see for example *Sonat Offshore v Amerada Hess* [1988] 39 BLR 1[1]. Where there are a number of possible meanings and the court is unable to objectively determine what the parties meant, such a clause may be unenforceable as it is too uncertain; see *British Electrical and Associated Industries (Cardiff) Ltd v Pateley Pressings Ltd* [1953] 1 WLR 280.

That said, so long as what the parties mean by "Force Majeure" is sufficiently certain there is no reason why a risk allocation scheme as set out in this sample clause would not be enforced.

United States: A clearly drafted *force majeure* provision is likely to be enforced in the U.S., provided that it applies only to events that were unforeseeable when the contract began and genuinely outside the control of the parties. *See* William Cary Wright, *Force Majeure Delays,* The Construction Lawyer, Fall 2006 at p. 33. The clause also needs to be clear as to what kinds of events fall within the definition of a *force majeure*. If, for example, a contract drafter wishes to treat acts of terrorism as a *force majeure*, it is best to be specific on that point. *Id.* Even if a contract does not contain a *force majeure* clause, a party may nonetheless claim the right to be excused from performance by a *force majeure* event, e.g., under theories of impossibility, impracticability or frustration of contract. Jocelyn L. Knoll & Shannon L. Bjorklund, *Force Majeure and Climate Change: What is the New Normal?,* Journal of the American College of Construction Lawyers, Vol. 8, No. 1 at p. 2 (2014).

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[1] The relevant provision in that case began:

> 22 Force Majeure
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> Neither party hereto shall be liable except under the indemnities provided herein and for the payment of monies due hereunder for failure to perform the terms of the Agreement when performance is hindered or prevented by strikes (except CONTRACTOR induced strikes by CONTRACTOR'S personnel) or lockout, riot, war (declared or undeclared), act of God, insurrection, civil disturbances, fire, interference by any Government Authority or other cause beyond the reasonable control of such party.

In its judgment, the Court of Appeal rejected the argument that the words "or other cause beyond the reasonable control of such party" had to be read disjunctively from the other examples of disaster listed in Article 22. Further, the Court found that an event might be within the reasonable control of a party, but not be negligent: it should not be assumed that the notion of "force majeure" extends to every event that has occurred without negligence.

Comments from Civil Law Jurisdictions:

Chile: Under the principles of *pacta sund servanda* and party autonomy, the parties are free to establish a force majeure provision that may add or exclude elements from the default definition of force majeure, which applies in the case there is no particular agreement between the parties on the subject. The limits to the ability of the parties to change the default rule on force majeure are basically twofold: (i) parties cannot affect third party rights and (ii) they cannot release each other from potential liability arising future willful misconduct or gross negligence. The specific wording of the provision that modifies the default rule on force majeure is crucial in determining whether the force majeure defense will be available for a party or not, as such a provision may or may not change the standard elements of force majeure, mainly the unforeseeable nature of the event and the impossibility to overcome it.

Finland (and Sweden): Finnish and Swedish law are part of the Nordic legal family which is a sub-group within the civil law family. The Contracts Act, similar in all Nordic countries, lacks detailed provisions and does thus not compare with other civil laws. No specific law covering construction contracts exist in the Nordic countries. For example force majeure is not defined in the Nordic laws. The legal systems base to a large extent on contract law principles which may fill in gaps in contracts and case law – *pacta sunt servanda* is prevalent and strongly upheld in b2b relations.

Finland:

Sample Clause 1 which in essence shifts all force majeure risks, except the Employer's own delay related costs, to the Contractor, may be acceptable depending on the facts of the case, the balance between the parties, etc. The below comments address first the extension of time point, then the "no monetary compensation" feature.

1. Time extension is the natural consequence of a force majeure event if additional time is required. The General Conditions for Building Contracts YSE (hereafter YSE) entitle the Contractor to receive extension of time for force majeure under certain circumstances (i.e. it is not automatic – assume the sample clause is simplified in this respect and not intended to grant an automatic extension). The Contractor is required to notify of a force majeure delay and to mitigate the delay, etc.

It is, however, questionable whether the Contractor could be bound in *infinitum* in particular without compensation. YSE entitles the Contractor to terminate for force majeure if the works are interrupted for a long and indefinite period on account of exceptional circumstances. This may be the end result for the Sample Clause (on the basis of practice).

2. The parties are free to agree that neither party shall be entitled to monetary compensation for extension of time due to force majeure events outside the control of the parties. The right to receive compensation is not granted under YSE, but compensation for additional costs caused is the main rule, unless otherwise agreed.

If the Contractor applies for compensation for his costs caused by force majeure, he shall do so by giving immediate notice (at the risk of otherwise forfeiting his right). There may, however, be limits to such a "no damage" clause: would it be reasonable that the Contractor receives no compensation for unavoidable additional costs, for storage? It will depend on the case and to some extent on the bargaining balance between the parties.

Netherlands:

Given the freedom of contract, a clause like Sample Clause 1 will in general be admissible under Dutch law, e.g., under the Dutch Civil Code (DCC).

Usually every imperfection in the fulfillment of an obligation is a non-performance of the debtor and makes him liable for the damage that the creditor suffers as a result, unless the non-performance is not attributable to the debtor (article 6:74 DCC). A non-performance cannot be attributed to the debtor if he is not to blame for it, nor accountable for it by virtue of law, a juridical act or generally accepted principles (common opinion) (article 6:75 DCC). With article 6:75 the DCC tries to provide a rule on how to determine what constitutes as force majeure. For example, an industry wide strike may be considered force majeure, whereas a strike at a Contractor's company is a circumstance which is likely to be attributed to the Contractor and will not lead to force majeure.

Notwithstanding article 6:75 DCC, parties are free to define in their contract the specific circumstances that may constitute force majeure.

In the event of force majeure, in general, the non-performance will not be attributable to one of the parties. Thus, extension of time without compensation of costs or reimbursement of damages suffered is a logical consequence.

Closely related to force majeure are the statutory provisions in the Dutch Civil Code that deal with unforeseen circumstances. The general rule is laid down in article 6:258 DCC, which states that upon a right of action ('legal claim') of one of the contract parties, the court may change the legal effects of that agreement or it may dissolve this agreement in full or in part if there are unforeseen circumstances of such a nature that the opposite party, according to the standards of reasonableness and fairness, may not expect an unchanged continuation of the agreement (…). According to the second paragraph of this clause, the court shall not change or dissolve the agreement as far as the unforeseen circumstances, in view of the nature of the agreement or of common opinion, should remain for account of the party who appeals to these circumstances.

Given article 6:250 DCC, it is not possible to derogate by agreement from article 6:258 DCC. Thus, this article related to unforeseen circumstances is mandatory law.

Specifically, for construction contracts a further rule is given in article 7:753 DCC. This clause deals with cost increasing circumstances. It states that when, after the conclusion of the

construction agreement, cost-increasing circumstances arise or come to light that cannot be attributed to the Contractor, the court shall, upon a legal claim of the constructor, adjust the agreed price entirely or partially in proportion to the cost-increase, provided that the Contractor, at the moment that he stipulated to a fixed price, did not have to reckon with the possibility that these circumstances would occur. The provision of article 7:253 DCC only applies if the Contractor has warned the principal as soon as possible of the need of a price increase, so that the principal either can make use of the right to terminate the agreement, or can make a proposal to restrict or simplify the work to be performed (article 7:253 sub 3 DCC).

Construction contracts in The Netherlands are frequently based on one of two standard forms of contract. For more traditional agreements, where the design and specifications are prepared by or on behalf of the Employer, and the Contractor is primarily responsible for the construction works, the Uniform Administrative Conditions for the Execution of Works and Technical Installation Works 2012 ('UAC 2012') are frequently used. Paragraph 47 of these UAC 2012 deals with cost-increasing circumstances. This provision is more or less similar to the statutory provision, albeit that the claim for reimbursement is only awarded if the cost increasing circumstances cause a substantial increase in the cost of the works. This being a crucial refinement, became clear several years ago in the case law regarding the increase in steel prices. In those cases, arbitrators awarded claims by subcontractors for whom the steel work represented a large fraction of the total contract sum, but denied similar claims by prime Contractors for whom the increased steel price only had marginal effect on their total contract sum.

For Design & Build contracts, the Uniform Administrative Conditions for Integrated Contracts 2005 ('*UAV-GC 2005'*), are used as standard form of contract. Paragraph 44 of this model form deals with cost increasing circumstances. This is a provision similar to paragraph 47 of the UAC 2012, with the exemption that no reference is made to the fact that the cost increase needs to be substantial.

Sweden: In essence the position is the same under Swedish law as under Finnish law. The General Conditions AB 04 (hereafter AB) include an obligation of the Contractor to notify without delay about an event which may cause delay, and he may forfeit its right to extension if such notification is neglected. The conditions also include and obligation to mitigate the delay at the cost of the Employer (which is different from the Sample clause). AB also includes a provision whereby the Contractor may terminate the contract if the works have to be suspended for such a long time that the assumptions and conditions underlying the contract have substantially changed. The end result for the Sample Clause may be the same as under Finnish practice.

CLAUSE 2 – "NO DAMAGE FOR DELAY BY EMPLOYER" (prime contract)

Sample: If the Project is materially delayed by an act or omission attributable to the Employer or any of its consultants, the Contractor's sole remedy shall be an extension of the Contract Time.

Comments from Common Law Jurisdictions:

Australia: As noted in relation to clause 1 above, Australian forms almost universally anticipate the existence of the 'prevention principle' (derived from *Peak v McKinney* (1976) 1 BLR 111 – for recent application, see *Probuild Constructions (Aust) Pty Ltd v DDI Group Pty Ltd* [2017] NSWCA 151). They do this by including a robust right in the contractor to receive an extension of time (directed, primarily, at reducing the liquidated damages otherwise payable on account of that delay) for 'acts of prevention' by the employer or those for which the employer is responsible, as against the contractor.

In relation to the 'sole remedy' aspect of the clause, Australian standard forms tend not to be drafted along these lines, but might render a similar result via an exclusion of liability provision. For the reasons noted at the outset, however (especially, the unfair contract terms regime under the Australian Consumer Law and judicial interpretative wariness towards clauses which purport to remove general law rights – see, eg *Concut Pty Ltd v Worrell* (2000) 75 ALJR 312), a clause which purports to remove the general law right to damages for a breach of contract would be regarded as an exclusion of liability clause and therefore subject to heightened scrutiny if ambiguous.

England: This sample clause is an exclusion clause, since it seeks to exclude the Employer's liability for monetary compensation. If the clause is sufficiently clear, and is negotiated freely between parties of broadly equivalent bargaining power, it is likely to be enforced by an English Court. The recent trend of appellate decisions is to leave such parties to their own contractual fate. In *Persimmon Homes v Ove Arup and Partners Ltd* [2017] EWCA Civ 373 Lord Justice Jackson provided the following guidance:

> In major construction contracts the parties commonly agree how they will allocate the risk between themselves and who will insure against what. Exemption clauses are part of the contractual apparatus for distributing risk. There is no need to approach such clauses with horror or with a mindset determined to cut them down. Contractors and consultants who accept large risks will charge for doing so and will no doubt take out appropriate insurance. Contractors and consultants who accept lesser degrees of risk will presumably reflect that in the fees which they agree.

That said, arbitrators are sometimes more willing to take an interventionist approach where they see that as necessary to recognize the underlying merits of a case, and might be more persuadable of some available principles of law, viz:

- Exclusion clauses are subject to a number of restrictive principles, including the Alderslade principle[2], whereby exclusion clauses are treated as not extending to cases of negligence unless negligence is expressly referred to. This principle is part of the wider approach that exclusion clauses are to be construed *contra proferentem*.

- This same approach is to be seen in the principle that in construing a construction contract "one starts with the presumption that neither party intends to abandon any remedies for its breach arising by operation of law, and clear express words must be used in order to rebut this presumption."[3]

- Thirdly, if the clause is to be found in the standard terms and conditions of the Employer, it might be vulnerable to attack if it can be said to fail the requirement of reasonableness under the Unfair Contract Terms Act 1977[4].

United States: "No damage for delay" clauses tend to be disfavored, because they contradict the general principle that a party should have responsibility when it causes delay to another party. A few states in the U.S. have enacted laws that make "no damage for delay" clauses unenforceable. *See, e.g.,* Kansas (Kan. Stat. Ann. § 16-1907) (public contracts only), Minnesota (Minn. Stat. § 15.411) (public contracts only), Missouri (Mo. Rev. Stat. § 34.058) (public works only), New Jersey (N.J. Rev. Stat. § 2A:58B-3) (public contracts only), North Carolina (N.C. Gen. Stat. § 143-134.3) (public contracts only), Ohio (Ohio Rev. Code §§ 4113.62(C)(1) and (2)), Virginia (Va. Code § 2.2-4335(A)) (public contracts only), and Washington (Wash.Rev. Code § 4.24.360). In most states, however, "no damage for delay" clauses are generally enforceable, subject to several potentially broad exceptions. Under those exceptions, the waiver of delay damages will typically not be enforced with regard to delays that (a) were not within the parties' contemplation at bid time, (b) amount to an abandonment of contract, (c) were caused by fraud or bad faith of the other party, or (d) were caused by active interference of the other party. *See* Jon M. Wickwire, Thomas J. Driscoll, Stephen B. Hurlburt and Mark J. Groff, Construction Scheduling: Preparation Liability and Claims at § 7.09 (2017); *see also* Susan Sisskind Dunne, *'No Damage for Delay' Clauses,* The Construction Lawyer, April 1999 at p. 38.

Comments from Civil Law Jurisdictions:

Chile: "No damage for delay" provisions will be generally enforced in Chile, provided that they do not imply a release from potential liability arising from future willful misconduct or gross negligence.

[2] *Alderslade v Hendon Laundry Ltd* [1945] KB 189 at 192, per Lord Greene.
[3] *Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd* [1976] BLR 73.
[4] "…that the term shall have been a fair and reasonable one to be included having regard to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made."

Finland: Sample clause 2 goes further than Clause 1 in shifting risks to the Contractor who would bear almost all risks for an Employer delay which is outside his control. Clause 2 would no doubt be scrutinized more critically than Clause 1 which is closer to Nordic practice.

The parties are free to agree on a "no damages" & "sole remedy" clause, but such a clause is not commonly used in the Nordic countries and is consequently not included in the agreed general conditions for construction works (YSE, AB etc). The main rule is that the party causing delay damage is responsible to compensate the other party.

Whether Clause 2 would be upheld in a dispute will depend on the facts of the case, balance between the parties etc. The answers to the following questions may be relevant to the acceptability of the clause:

- are the parties of equal strength (bargaining power, financially, etc.) and have they had access to equal and relevant information on the risks?;
- which are the causes of the delay: breach of contract by the Employer itself or a subordinate?, is the event within Employer's control, is the breach substantial etc.?
- length of the delay and magnitude of the Contractor's costs caused by the delay (relation to contract price) and its causality with the act of the Employer; etc.

Further, albeit excluded remedy here as extension of time is the sole remedy, the Contractor may under YSE be entitled to terminate the contract if the completion is prevented through acts by the Employer.

Netherlands: As mentioned in the general note on Dutch contract law (at the end of this paper), parties are to a great extent free to draft their contracts in the way that suits them. Given this freedom of contract, in general, there is no rule that prevents shifting certain risks from the Employer to the Contractor. However, based on the principle of reasonableness and fairness, a judge or an arbitrator may set aside such contract clause, if under the given circumstances such clause would be unacceptable. It is clear that a contract clause like the sample clause, contradicts the principle that the party to which a delay is attributable, should bear the consequences of such a delay.

In 2011, the Arbitration Board for the Building Industry ('*Raad van Arbitrage voor de Bouw*') decided in an appeal of an arbitral award regarding a clause similar to sample clause 2 (*Arbitration Board for the Building Industry, April 4, 2011, case number 71.496, TBR 2011/173*). A municipality had entered into a construction agreement with a Contractor. The contract stipulated that in the event of extension of time ('*EOT*'), the Contractor is not entitled to reimbursement of costs or compensation for damages suffered due to the extension of time. The construction time nearly doubled and damages relating to the EOT amounted to nearly 30% of the original contract price. Despite the contract clause, the Contractor sued the municipality to retrieve its damages. Unfortunately, arbitrators decided that the exoneration

was not in conflict with the principle of reasonableness and fairness, and the Contractor's claim was denied.

Sample Clause 2 deals with an exoneration for damages as a result of acts or omissions by or attributable to the Employer. This raises the question whether liability for own unlawful acts can be excluded. In a case decided by the Supreme Court on May 19, 1967 (*ECLI:NL:PHR:19667:AC4745, NJ 1967/261, Saladin/HBU Bank*), the Supreme Court ruled that it depends on the circumstances of the case whether an exoneration should be accepted. Circumstances mentioned by the Supreme Court were, the seriousness of the fault, the nature and content of the agreement containing the exoneration, the way the clause has been agreed upon and to which extend the other party has been aware of the meaning of such a clause.

Under current law the question if an exoneration should be upheld, will likely be answered on the basis of article 6:248 sub 2 DCC. Is it according to the standards of reasonableness and fairness acceptable that a party invokes an exoneration. From a recent decision of the District Court Gelderland (June 7, 2017, ECLI:NL:RBGEL:2017:2995), it can be concluded that, amongst other circumstances, the situations mentioned by the Supreme Court in the Saladin/HBU case are still valid.

Sweden: Under Swedish law the so-called control responsibility is applied in breach of contract cases. This type of responsibility is referred to in AB and it can therefore be considered to be recognized in construction practice. To avoid control responsibility, the party in fault (here the Employer) must prove that the breach of contract was out of its control (which it is not as it is admitted as due to an Employer act or omission). Under Swedish law he would be "exculpated" only if it was a hardship like event. The set-up of Sample Clause 2 means that the parties have excluded the control responsibility which the Employer otherwise would have. The current state of the law does not clarify whether control responsibility is a general principle in contract law or not. This however varies between the Nordic countries (see Ramberg & Ramberg, Allmän avtalsrätt, Stockholm 2016 p. 240-.). The comment on AB Ch 4 § 3 states that when interpreting this clause one seeks guidance from legal practice regarding control responsibility.

CLAUSE 3 – "PAY IF PAID" (subcontract)

Sample: Contractor's actual receipt of payment from the Employer (or from other third parties) for the Work shall be an absolute condition precedent to Subcontractor's right to payment from Contractor. Subcontractor therefore shares with Contractor in assuming the risk that the Employer will fail or be unable to pay for the Work after it is performed.

Comments from Common Law Jurisdictions:

Australia: The eradication of 'pay if paid' and 'pay when paid' clauses from the contracting chain was a major policy driver of the state-based 'security of payment' legislation which was implemented during the past two decades. They are rendered void in applicable contracts under the *Building and Construction Industry (Security of Payment) Act 2009* (ACT) s 14, *Building and Construction Industry Security of Payment Act 1999* (NSW) s 12, *Construction Contracts (Security of Payment) Act 2004* (NT) s 12, *Building and Construction Industry Payments Act 2004* (Qld) s 16, *Building and Construction Industry Security of Payment Act 2009* (SA) s 12, *Building and Construction Industry Security of Payment Act 2009* (Tas) s 16, *Building and Construction Industry Security of Payment Act 2002* (Vic) s 13, and *Construction Contracts Act 2004* (WA) s 9.

Note, however, that many construction-related contracts are not subject to this legislation: the various Acts carve out from their operation contracts for certain sectors and types of work in a manner broadly consistent with (but, subject to significant differences in each Act) the exceptions under the *Housing Grants, Construction and Regeneration Act 1996* (UK). Thus, residential building contracts between Employers and Contractors, and many contracts in energy and resources-related sectors, are excluded under the Acts (that said, by way of example of the disparity between the States, the Tasmanian Act does not exclude residential building contracts).

England: Throughout the UK, pay-when-paid clauses (conditional payment provisions) are ineffective unless the ultimately paying party is insolvent.[5]

United States: On private construction projects and sometimes even on public projects, there is a risk that the Employer will be unable to pay the full agreed price for the work. Prime Contractors sometimes seek to pass that risk through to Subcontractors and Suppliers by way of a "pay if paid" provision. Subcontractors argue that the Prime Contractor usually has more knowledge about the Employer and is in a more informed position to handle the risk of non-payment (or to protect itself by maintaining positive cash flow on the project). If a "pay if paid" clause is clearly written, however, most U.S. states are likely to enforce it. *See* Ronald P. Friedberg, *'Pay-If-Paid Contract Provisions, Providing Some Enforcement Consistency and Predictability in an Unsettled Area of Law,* 57 No. 2 DRI for Def. 23 (2015); Kegler Brown Hill &

[5] Section 113 of the Housing Grants, Construction and Regeneration Act 1996.

Ritter, *Contingent Payment Clauses in the 50 States,* published by the American Subcontractors Association, Inc. (2012). There are, however, a few states that refuse to enforce "pay if paid" clauses, usually on the theory that they conflict with laws guaranteeing lien rights to unpaid Subcontractors. *See, e.g., Wm. R. Clarke Corp. v. Safeco Ins. Co.,* 938 P.2d 372, 377 (Cal. 1997) and *West-Fair Elec. Contractors v. Aetna Cas. & Sur. Co.,* 87 N.Y.2d 148, 155 (N.Y. 1995). On federal projects, Subcontractors are generally protected because the Prime Contractor is required to post a "Miller Act" bond assuring payment. Courts have held that a "pay if paid" clause does not waive subcontractor rights under such "Miller Act" bonds. *U.S. for Use and Benefit of Walton Technology, Inc. v. Weststar Engineering, Inc.,* 290 F.3d 1199, 1207 (9th Cir. 2002).

Comments from Civil Law Jurisdictions:

Chile: "Pay if paid" provisions are valid and enforceable in Chile. Nevertheless, Subcontractors will always keep a remedy against the Prime Contractor if the Contractor has not acted diligently in enforcing its rights against the Employer in a way that affects the subcontractor. The burden of proof will remain with the Contractor in such case.

Finland: Sample Clause 3 would be unusual in Finnish construction practice. It shifts the risk for non-payment by the Contractor's contract parties entirely to its Subcontractor who has no control over the performance by the contracting parties "upstream". Sharing the payment risk with the Contractor is within freedom of contract, but the acceptability of such an "absolute condition" in a dispute will depend on the facts and circumstances of the case. It may be of relevance that the Subcontractor normally is in an inferior position *vis a vis* the Contractor.

If, for example the non-payment depends on the Contractor's failure, it is less likely that the clause is enforceable in a subcontract. If it again depends on a third party, it may be enforceable. If the cause of origin for the non-payment lies with the Subcontractor in question, the clause is naturally enforceable.

Subject to these boundary conditions, a clause granting the Subcontractor payment when the Contractor is paid may be enforceable unless it is excessively arbitrary. It is more likely to be acceptable if it can be construed as a deferred payment condition; if it leads to non-payment of works altogether for reasons outside the control of the Subcontractor in question, it is less likely to be enforceable.

Netherlands: Given the freedom of contract under Dutch Law, a 'pay if paid' or similar contract clause is not forbidden (*see: 'Onderaanneming in Europa', Prof.Mr.Dr. M.A.B. Chao-Duivis, Tijdschrift voor Bouwrecht 2013/39*). This type of payment clause, however, is not common in more traditional domestic construction contracts. International construction contracts and DBFM(O) contracts are more likely to have a 'pay when paid' or 'pay if paid'

clause. With respect to the payment risk, in Dutch literature a distinction is made between a 'pay when paid' clause and a 'pay if paid' clause (*see: Mr.Drs. S. van den Bogaart and Mr. L.F. Droge, 'Back to back contracteren bij DBFM(O)-projecten, Tijdschrift voor Bouwrecht, 2015/97*). It is argued that the payment risk is not born by the Subcontractor in the event of a 'pay when paid' clause, whereas the Subcontractor does bear that risk in case of a 'pay if paid' clause. As noted in the general introduction, article 6:248 sub 2 DCC provides for an opportunity to set aside a contractual rule if, given the circumstances, such rule would be unacceptable to the standards of reasonableness and fairness.

Sweden: If, for example the non-payment to the Subcontractor depends on the Contractor's failure, it is less likely that the clause is enforceable, because the matter is within the Contractor's sphere of control. For one-sided contracts see NJA 2005 p 142 (one-sided interest rate clause entitling a party to increase the interest rate when market rates increased was to be interpreted as double-sided, i.e. to lower the interest rate when market rates decreased; the Supreme Court based its judgement on the duty of loyalty (in essence good faith, see below).

CLAUSE 4 – WAIVER OF UNTIMELY CLAIM

Sample: Within three (3) business days after the occurrence of any event that would entitle Contractor to an increase in the Contract Price or Contract Time under this Contract, Contractor shall submit written notice of that event to the Engineer. That notice shall include Contractor's best estimate of the resulting cost and time impacts. Failure to submit such written notice within the required time period shall be treated as a waiver of the Contractor's right to additional compensation or time based on the event in question.

Comments from Common Law Jurisdictions:

Australia: Provisions requiring notice of claims are very common in Australian standard forms and negotiated project contracts. So too are provisions purporting to bar claims if those notice provisions are not strictly satisfied. At common law, these time bar clauses are generally enforced. For a recent example, see *CMA Assets Pty Ltd v John Holland Pty Ltd* [No 6] [2015] WASC 217. This is consistent with well-established authority that even an exclusion clause is to be given 'its natural and ordinary meaning', subject to the usual principles of contractual interpretation, including the *contra proferentem* principle. (*Darlington Futures Ltd v Delco Aust Pty Ltd* (1986) 161 CLR 500, 510.)

For the Employer, the main risk arises from estoppel. An example of how this might arise is where an Employer has expressly represented that strict compliance with the notice clause was not necessary, inducing the Contractor to assume strict compliance was not necessary, and to rely on that assumption to its detriment.

In very limited circumstances, it might be possible to argue that the model clause was statutorily void as an unfair contract term under the Australian Consumer Law. As discussed in the special note on Australia, this argument would only be possible (outside of the business-to-consumer sphere) for businesses with fewer than 20 employees, and generally for a contract sum of AUD300,000 or less.

A curious argument has been raised that some time bar clauses might be unenforceable because of recent Australian cases on the penalty doctrine. (Philip Davenport, '*Andrews v ANZ* and Penalty Clauses' (2012) 147 *Australian Construction Law Newsletter* 32.) This argument has not been authoritatively tested, and has been persuasively critiqued by other commentators. (John Bond, 'Contrary to What You Might Have Heard, a Properly Drafted Contractual Time Bar Will Not Attract the Penalty Doctrine' [June 2013] *The Arbitrator & Mediator*, 6.)

England: In principle, where clearly expressed such clauses are valid.[6] However, the English courts have been prepared to draw from a fairly wide arsenal of arguments in order to relieve a Contractor from the harsh consequences of failing to give a required notice. The following approaches have in the past been taken:

- That the giving of notice is not a condition precedent, such that a failure to give notice does not deprive the Contractor the right to the relief in question, but merely renders him liable for the damages (if any) which flow from lateness of the notice[7];
- That a requirement may not be a condition precedent, even if expressly stated to be so, if that result would be a commercial nonsense[8];
- That the notice is to be read *contra proferentem*, or otherwise read down[9];
- That the requirements for notice may be loosely construed, such that even documents such as daywork sheets may satisfy the notice requirements[10];
- That the notice requirement applies only to the contractual entitlement, and not to any parallel entitlement by way of damages[11];
- That the Employer who has prevented compliance with the clause may not rely on it[12];

[6] See, for example, *Education 4 Ayrshire Ltd v South Ayrshire Council* (2010) Const LJ 327.
[7] *London Borough of Merton v Leach* (1985) 32 BLR 51; *Temloc v Errill* (1987) 39 BLR 30, 1 CLR 109
[8] Koch Hightex GmbH v New Millennium Experience Company Limited; (1999) CILL 1595.
[9] *Tersons v Stevenage* [1963] 2 Lloyd's Rep. 333, [1977] 5 BLR 54.
[10] *Henry Boot Construction v D F Mooney* (1996) 12 Const. L.J. 37.
[11] There would appear to be no reason why the Australian case of *Decor v Cox* (No 2) [2005] SASC 483 would not be followed in England.

- That the requirement to give notice may have been waived, or negated by an estoppel;
- That the obligation only bites when the Contractor is aware, or has the means to be aware, of the event;[13]
- That the burden is on the party alleging the notice provision was not complied with to establish that notice was give too late; [14]
- That the contractual provision is insufficiently clear as to the nature of the notice that is required.[15]

In addition, it has been suggested that further avenues to the same effect might, in some circumstances, be available:

- That the notice provision might be construed as a forfeiture clause, such that the courts are empowered to grant relief from forfeiture;
- That the notice provision forms part of a contractual mechanism that has broken down;
- That the Employer has waived compliance with the term.

United States: In U.S. public and private contracting, it has become increasingly common for contract drafters to insert clauses providing that claim rights are waived unless they are asserted in writing within a defined number of days. In many instances, these clauses are one-sided, requiring prompt written notice of claims by one party but not by the other. Typically, the party who drafts the contract is the one who is not held to a strict claim notice requirement. A few courts have given strict enforcement to such clauses, as in the 5 to 4 decision of the Washington Supreme Court in *Mike M. Johnson, Inc. v. County of Spokane,* 150 Wn.2d 375, 78 P.3d 161 (2003) and the Supreme Court of Virginia's decision in *Commonwealth v. AMEC Civil, LLC,* 280 Va. 396, 699 S.E.2d 499 (2010). Under U.S. federal law and the laws of most states, however, a claimant can overcome a defense based on lack of timely notice by showing that the party asserting that defense has actual or constructive notice of the event at issue, or that lack of notice caused no material prejudice to the party who alleges lack of timely notice. U.S. authorities on this issue are summarized by Douglas Oles in "*Lack of Claim Notice as a Defense to Construction Claims*," The Construction Lawyer, Winter 2012 at p. 6.

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[12] See *Koch Hightex GmbH v New Millennium Experience Company Limited* (1999) CILL 1595 and *Bluewater Energy Services BV v Mercon Steel Structures BV* (2014) 155 ConLR 85. Note also this passage from Keating at 8-031:

> There are, however, conceptual difficulties, it is submitted, where the event causing delay has been caused by the employer's default, for example a failure on the part of the employer to give possession, or by the default of the employer's agent, for example a failure by the architect to supply drawings in time. In such a case the employer would, if it were able to recover liquidated damages in relation to that delay, benefit from its act of prevention.

[13] *Obrascon Huarte Lain SA v Her Majesty's Attorney General for Gibraltar* [2014] BLR 484.

[14] *Obrascon Huarte Lain SA v Her Majesty's Attorney General for Gibraltar* [2014] BLR 484.

[15] See *Steria Ltd v Sigma Wireless Communications Ltd* [2008] BLR 79 at [90 – 91]; *Persimmon Homes (South Coast) Ltd v Hall Aggregates (South Coast) Ltd* [2008] EWHC 2379 at [298].

Comments from Civil Law Jurisdictions:

Chile: A clear provision regarding waivers due to untimely claims are normally upheld in Chile. Nevertheless, any unclear extent of such a one-sided provision will be interpreted against the drafter. If contract is subject to arbitration, the arbitrator may disregard this kind of formal issues if it acts *ex aequo et bono*.

Finland: Sample Clause 4 concerns forfeiture of rights if the Contractor fails to meet a very short 3 days' notice period.

Forfeiture of rights for failed notice was accepted by the Supreme Court in the precedent case KKO 2008:19. The contract was governed by YSE which do not contain a waiver clause, but in spite of this the Supreme Court ruled that the Contractor had forfeited his entitlement to claim compensation for change works. Hence it must be assumed that explicit waiver clauses for claims would be upheld. Three business days is a very short notice period, but in B2B relationships likely to be upheld depending on the facts.

The aforementioned court case also provides important insight into Finnish law specifically, and this may apply also in case of other Nordic laws, namely that gaps in contracts are filled with reasoning based on legal principles (and perhaps commercial sense?).

Netherlands: Sample Clause 4 can be considered as a contractual expiry date ('*vervaltermijn*') for the forfeiture of certain rights. For example, the right to claim additional time or costs. Under Dutch law there is no rule that forbids parties to include expiry dates in their contracts. Parties are free to agree that certain rights for which no statutory expiry date exists must be exercised within a specific time period (*see: Asser/Hartkamp & Sieburg 6-II* 2009, nr. 438* and *Mr. S.J.H. Rutten, Praktijkboek verjarings- en vervaltermijnen in de Bouw, 2014, par. 1.3.1* and *1.3.2.2*).

To answer the question which specific rights are governed by the expiry date, one needs to look at the content of the expiry clause. If needed, arbitrators or courts need to explain these clauses in accordance with the '*Haviltex* formula' as mentioned in the general introduction to Dutch contract law at the end of this paper (Supreme Court, March 13, 1981*, NJ 1981/635, Haviltex*).

A common contractual expiry date in construction law is the time period in which a claim for defects must be filed against a Contractor. Paragraph 12 sub 4 of the UAC 2012, stipulates that a legal claim on account of a defect for which the Contractor is liable according to paragraph 12, is inadmissible after a delay of five years after the date on which the works are considered completed and accepted in accordance with the provisions of paragraph 10 of the UAC 2012. In the event of a partial or complete collapse of the works, the threat of such collapse or if the works have come to be unfit or threaten to be unfit for the purpose for which they were intended, this time period is ten years.

With respect to a claim for extension of time, the UAC 2012 stipulate in paragraph 8 sub 4, that a request by the contractor for extension of time shall only be taken into consideration if such a request is done in writing and, except for dispensation granted by the employer's agent, is delivered to the Employer's agent at least fourteen days before expiration of the term.

Sweden: As a consequence of the general obligation under Swedish law to mitigate the counterparty's losses an obligation to notify known events exists without express law or contract basis.

Under AB in case of risk for delay and a party has realized or should have realized this, he shall submit a written notice to the other party. If such notice is neglected, he loses the right to assert a claim unless the other party realized or should have realized that the circumstance would affect the contract time. The Contractor must under AB without delay obtain the Employer's opinion if there is a risk that the contract price will be exceeded.

The term "without delay" in these cases would in practice be decided in court proceedings. The outcome varies from case to case. The Swedish Supreme Court has been restrictive with regard to forfeiture of rights for delayed notice, ie "without delay" may be a longer period than a few days, all depending on the circumstances (NJA 2007 p. 909. NJA 2004 p. 862). Thus the acceptability of the Sample Clause seems less certain in Sweden than in Finland.

CLAUSE 5 – BINDING DECISION BY ENGINEER

Sample: If a dispute arises under the Prime Contract that cannot be resolved through mutual negotiation, either party may submit the issue for review by the Employer's Engineer, whose decision shall be final and binding upon the parties.

Comments from Common Law Jurisdictions:

Australia: No standard form contract in common use includes a dispute resolution mechanism of this nature. In the limited situations in which the Australian Consumer Law prohibits unfair contract terms, the clause could well be void.

An initial complication is that the clause could be characterised in several ways: as an attempted reference to arbitration, as expert determination — or most likely simply as a final and binding determination by the Employer's agent.

Similar clauses have occasionally come before Australian courts. Generally, Australian courts have tended to uphold such clauses where they concern valuations, although they often distinguish between mechanical and discretionary assessments. For a detailed discussion of the authorities, see Trevor Thomas, 'The Value Is Whatever I Say It Is: Determinations by the Principal under Construction Contracts' (2009) 25 *Building and Construction Law* 246.

England: Although not so expressed, a clause such as this might well be treated as an arbitration agreement under the Arbitration Act 1996. English law holds that the question of whether a particular dispute resolution mechanism is or is not an arbitration agreement is to be determined as a matter of substance, and not merely by the label that the parties use (or do not use).[16]

In practice, construction contracts in England typically contain a rather different regime, whereby rulings by the Employer's Engineer are not treated as arbitral awards, but as an extension of the certification mechanism. These provisions typically give the parties a limited time to challenge such rulings.[17]

United States: Generally, U.S. courts are inclined to enforce clauses explicitly designating architects as the final decision makers on disputes. *See, e.g., Maross Constr., Inc. v. Cent. New York Reg'l Transp. Auth.*, 488 N.E.2d 67, 70 (N.Y. 1985) (enforcing a broad clause authorizing the architect to render binding final decisions on factual and legal disputes); WERNER SABO, LEGAL GUIDE TO AIA DOCUMENTS § 4.31 (5th ed. Supp. 2017). Unless the architects act in bad faith, fraudulently, arbitrarily, capriciously, or outside the scope of their authority, courts are unlikely to alter the architects' decisions. *See Ingrassia Constr. Co., Inc. v. Vernon Tp. Bd. of Educ.*, 345 N.J. Super. 130, 138 (summarizing conditions warranting invalidation of architects' decisions); *Cty. of Rockland v. Primiano Constr. Co.*, 409 N.E.2d 951 (N.Y. 1980) (holding that the architect lacked the authority to hear controversies two years after the operational phase of the construction). In government contracts, the Contract Disputes Act of 1978 authorizes a contractor to seek judicial review of a decision made by a contract officer or the agency board involving a question of law regardless of other contractual terms. 41 U.S.C. § 7107(b) (Westlaw through Pub. L. No. 115-40.); *SUFI Network Serv., Inc. v. United States*, 122 Fed. Cl. 257, 260 (Fed. Cl. 2015) (analyzing the line of cases after the Supreme Court's decision in *Wunderlich*). In individual cases, it may be possible to challenge the architect's independence and/or failure to provide due process of law.

In recent years, architects have resisted being asked to arbitrate disputes between Employers and Contractors, both to avoid risk and for practical reasons. Part of this is due to the increasing complexity of construction projects and the issues that arise on them. *See, e.g.*, *Ingrassia Const. Co., Inc.,* 345 N.J. Super. at 138. In 2007, the American Institute of Architects (AIA) revised its widely used General Conditions to distance the architect from disputes by encouraging the parties to select a different Initial Decision Maker. Philip L. Bruner & Patrick J. O'Connor, Jr., 2 BRUNER & O'CONNOR CONSTRUCTION LAW § 5:20.20, Westlaw (database updated December 2016).

[16] See e.g. *Langham House Developments v Brompton Securities* (1980) 265 Estates Gazette 919 *and Cape Durasteel v Rosser & Russell* (1995) 46 Con LR 75.

[17] See, for example, clause 19 of the Infrastructure Conditions of Contract 2014.

Comments from Civil Law Jurisdictions:

Chile: Conflict resolution provisions are enforceable in Chile according to its terms. Nevertheless, under standard rules the parties may challenge the neutrality of the decision maker in case it is clearly related to one of them.

Finland: Sample Clause 5 is uncommon in the Nordic countries. Consequently the YSE does not deal with this kind of issue. It cannot, however, be ruled out that such provisions could be included in construction contracts if found useful and advisable.

For ongoing disputes in the course of the project, such a clause may be acceptable under freedom of contract. The bias issue (Employer's Engineer) is likely to be problematic, and acceptability might be limited to non-material disputes provided that the Engineer has acted reasonably and taken both parties' interests into account (based on the loyalty principle). Acceptability would be improved if the Engineer's decision can be overruled by DAB decision/ arbitral award. The set up as unilateral decision making on the part of the Employer side fulfills criteria for unreasonable contract terms (in particular if the contract parties are unequal).

Netherlands: For domestic construction contracts governed by the standard contract forms UAC 2012 ('UAV 2012') or UAV-GC 2005, a clause such as sample Clause 5 is uncommon. Even though paragraph 47 sub 5 of the UAV GC 2005 offers the opportunity to settle disputes by a Board of Experts ('*Raad van Deskundigen*') instead of arbitration, the majority of agreements under the UAV GC 2005, explicitly exclude the Board of Experts.

With a clause like sample Clause 5, parties agree to settle their disputes in a different way than through the regular courts or by way of arbitration.

Article 17 of the Dutch Constitution, states that no one may be prevented against his will from being heard by the courts to which he is entitled to apply under law. This article in the Dutch Constitution is in line with article 6 of the Human Rights Treaty ('*Europees Verdrag tot bescherming van de rechten van de mens en de fundamentele vrijheden,* Rome 1950'). In short, according to article 6 EVRM, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law.

Article 1020 of the Dutch Code of Civil Procedure ('*Wetboek van Burgerlijke Rechtsvordering ('Rv.'*)), stipulates that parties, by agreement, may decide to have their disputes settled by way of arbitration instead of the civil courts. If disputed, this arbitration agreement must be proven by a document. It is sufficient that this document refers to general conditions that contain an arbitration clause.

Sample Clause 5 is not an arbitration clause, but a clause by which parties decide to settle their disputes by virtue of a decision of a third party ('*Bindend Advies*'). Such an agreement is admissible under Dutch Law (*see: Hoge Raad* 24 September 1964*, ECLI:NL:PHR:1964:AC4487, NJ 1965/359*), and has a legal basis in article 7:900 sub 2 of the DCC. This article defines a settlement agreement ('*Vaststellingsovereenkomst*'). Under a settlement

agreement parties bind themselves towards each other, in order to end or to avoid any uncertainty or dispute about what applies to them legally, to the assessment and establishment of a new legal status between them. Article 7:900 sub 2, states that the assessment and establishment of their new legal status can be made by virtue of a joint decision of the involved parties or by virtue of a decision of one of them or of a third party.

I do note, that an assessment made by one of the parties or a third party can be annulled if its binding force, in view of its content or the way in which it was made, in the given circumstances would be unacceptable according to the standards of reasonableness and fairness (article 7:904 DCC).

From an enforcement point of view, however, there is an important difference between an arbitration award and a decision by a third party (*'Bindend Advies*'). The arbitral award is as such not enforceable under Dutch law. Enforcement in The Netherlands of an arbitral award can take place only after the Provision Relief Judge of the District Court in which the place of arbitration is located, has in pursuing a request of one of the parties granted permission for enforcement (*'verlof tot tenuitvoerlegging', article 1062 Code of Civil Procedure*). In general, obtaining this permission is a formality.

It is not possible to obtain permission for enforcement of a decision by a third party ('Bindend Advies'). If a party does not adhere to the decision of the third party, the party in who's favor the decision is rendered will need to start legal proceedings ordering the convicted party to adhere to the decision.

In an international context attention is drown to the New York Convention on the enforcement of foreign arbitral awards (*Convention on the Recognition and Enforcement of Foreign Arbitral Awards,* New York, 10 June 1958). This treaty is applicable to arbitral awards but not to third party decisions.

Caution should be exercised when drafting contracts with a counterparty, being a natural person who did not act in the course of his professional practice or business when he entered into that contract. For example, an agreement for the construction of a residence. Section 6.5.3 of the Dutch Civil Code, deals with standard terms and conditions. 'Standard terms and conditions' mean one or more contractual provisions or stipulations, drafted to be included in a number of contracts, with the exception of provisions and stipulations that indicate the essence of the performance under the obligation (article 6:231 DCC). Dispute resolution clauses are frequently found in general conditions.

Article 6:236 DCC stipulates several contract terms that, in a contract between a user and a counterparty, being a natural person who did not act in the course of his professional practice or business when he entered into that contract, are deemed to be unreasonably burdensome for that counterparty. Among these clauses is a stipulation which provides for the settlement of a dispute other than by a court with jurisdiction pursuant to law, unless it still allows the counterparty to choose for a settlement of the dispute by the court with jurisdiction

pursuant to law and this choice can be made within a period of at least one month after the user has invoked that stipulation in writing.

With respect to consumers, reference is further made to the Council Directive 93/13/EEC of the European Union, dated 5 April 1993, protecting consumers from unfair terms in contracts. Aim of this Directive is to protect consumers in the European Union from unfair terms and conditions that might be included in a standard contract for goods and services they purchase. The Directive introduces the notion of 'good faith' to avoid any significant imbalance in mutual rights and obligations. Conditions deemed unfair are not binding on consumers, but other terms are valid for both parties if the rest of the contract remains relevant and valid. When there is doubt about the meaning of a contract term, it should be interpreted in a manner favorable to the consumer.

According to article 3 of the Directive, a contractual term which has not been individually negotiated shall be regarded as unfair, if contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer.

A term shall always be regarded as not individually negotiated where it has been drafted in advance and the consumer has therefore not been able to influence the substance of the term, particularly in the context of a pre-formulated standard contract (article 3 sub 2 Directive).

The Directive provides for an Annex containing an indicative and non-exhaustive list of terms which may be regarded as unfair. A term which has the object or effect to excluding or hindering the consumer's right to take legal action or exercise any other legal remedy, particularly by requiring the consumer to take disputes exclusively to arbitration not covered by legal provisions, unduly restricting the evidence available to him or imposing on him a burden of proof which, according to the applicable law, should lie with another party to the contract, is a term that may be regarded as unfair.

Sweden: This kind of Engineer role is not generally part of Swedish construction practice. AB assume that small disputes are resolved in District Courts or mutually agreed proceedings. The same reservations as for Finland can be given for Sweden with regard to acceptability of Sample Clause 5.

CLAUSE 6 – INDEMNIFYING A PARTY FOR ITS OWN FAULT

Sample: Contractor shall defend and indemnify the Employer against any and all third party claims and assessments arising in connection with the Work, regardless of whether such claims or assessments arise from negligent acts or omissions of the Employer. Contractor shall maintain insurance to protect against such losses and damage, and the Contract Price shall include all premiums that must be paid to procure such insurance.

Comments from Common Law Jurisdictions:

Australia: Broadly speaking, clauses applying general assumption (and allocation) of risks to third parties, by way of indemnity, are consistently enforced across Australian standard forms of contract, and they are driven by the availability of insurance to cover such risks. It is not unusual for the Contractor to be required to indemnify the Employer against third party claims and to take out insurance policies covering risks borne by both parties (though, it will generally be understood that the Contractor would anticipate the need for such taking out within its tendered prices, if the insurance is not already held). In respect of third party claims as contemplated by the sample clause, these policies would primarily be for public liability and contract works.

That said, an unqualified indemnity by the Contractor to the Employer for the Employer's negligent acts or omissions, of the type in the sample clause, would be unusual under Australian standard forms (see, eg, PC-1 1998 clause 5.2 and AS4300-1995 clause 17.1). Rather, these forms tend to reduce the Contractor's liability to indemnify the Employer against third party claims (for example, in respect of personal injury or death, or loss of or damage to property) to the extent that an act or omission (including negligence) of the Employer, or those for which the Employer is responsible, contributed to the loss, damage, death or injury or death.

England: Clauses such as this have long been seen in the UK in standard plant hire contracts and in energy contracts. Provided they are sufficiently clear, they are generally enforceable and are seen as a legitimate means of allocating risk. However, it should be noted that the precise wording used may alter the effect of such clauses. For example, the terms "indemnity" and "hold harmless" are often used in such clauses, but do not have the same effect.[18]

United States: Parties to construction contracts often agree to defend and indemnify against third party claims arising from the indemnitor's negligence. Contract drafters often attempt, however, to expand the duties of defense and indemnity to cover third party claims arising from acts or omissions of the indemnified parties. Defenders of such clauses argue that it's easier for a single party to purchase insurance covering the entire project, and broad scope

[18] See, for example, *Farstad Supply AS v Enviroco Ltd* [2010] Bus LR 1087.

indemnity might help avoid litigation in cases where multiple parties contribute to a claim or loss. On the other hand, Contractors protest being held responsible for losses caused by the fault of other parties over whom they have no control, and they complain about paying increased premiums on insurance that becomes more expensive due to acts or omissions of other parties. The great majority of states have enacted some form of "anti-indemnity statute" that limits the enforcement of clauses that attempt to shift liability for one party's negligence to another party. Around 1/3 of the states prohibit clauses that require one party to assume liability for the "sole negligence" of another party, and over half of the states (including the most populous ones) prohibit clauses requiring indemnity for another party's sole or partial negligence. These statutes were surveyed by Dean Thomson and Colin Bruns in *Indemnity Wars: Anti-Indemnity Legislation Across the Fifty States,* Journal of the American College of Construction Lawyers, Vol. 8, No.2, p. 1 (2014) and are also addressed in Weinberg Wheeler, *Agreement to Indemnity & General Liability Insurance: A Fifty States Survey*, http://www.wwhgd.com/assets/attachments/50%20State%20Survey%2000810220.pdf. *See also* Matthiesen, Wickert & Lehrer, *Anti-Indemnity Statutes in All 50 States,* June 27, 2016, https://www.mwl-law.com/wp-content/uploads/2013/03/Anti-Indemnity-Statutes-In-All-50-States-00131938.pdf. Although one might expect that a duty to defend would be enforced similarly to a duty to indemnify, those two obligations tend to be treated separately, and U.S. law is less developed with regard to a contractual duty to defend.

Comments from Civil Law Jurisdictions:

Chile: Indemnity provisions that benefit the wrongdoer regarding damages arising from willful misconduct or gross negligence are void under Chilean law. Damages arising from other standards of liability (such as ordinary negligence) may be contractually allocated between the parties and such distribution will be normally enforced in Chile.

Finland: Sample Clause 6 would as drafted be unusual in Finnish practice, but they would not outright be rejected. Under YSE the Employer would be responsible for its own negligence towards the Contractor. The conditions include provisions concerning the insurances pertaining to the building project and a Contractor responsible for site management would take out insurance for all parties on the site.

If the Contractor is obliged to take out and maintain an all risks insurance covering all parties on the site and including the Employer, then the end result may cover the situation in the sample clause. Such a clause would not hold if the indemnitee (here Employer) was grossly negligent in its own performance. The premiums would customarily be assumed included in the contract price.

Netherlands: Given the freedom of contract, a provision as sample Clause 6, would be admissible. As for the insurance, it is not uncommon that the Contractor has to provide for the necessary insurances, such as a 'construction all risk' insurance ('*CAR verzekering*'). It would,

however, be rare if the Contractor would accept liability for claims or assessments arising from negligent acts or omissions of the Employer.

Under the standard forms of contract, an indemnification is common. For example, according to paragraph 6 sub 4 of the UAC 2012, the Contractor shall indemnify the Employer against any action, claim or demand by third parties for compensation for any damage insofar as such damage has been caused by the execution of the works and is attributable to negligence, lack of care or incorrect actions by the Contractor, his staff and labor, his Subcontractors or his suppliers. Under Dutch law, 'attributable' means that the Contractor is liable whether or not he is culpable. A similar clause can be found in paragraph 4 sub 11 of the UAV-GC 2005.

CLAUSE 7 – MONETARY CAP ON LIABILITY FOR CONTRACTOR OR DESIGNER

Sample: Notwithstanding any other provision in this Contract, the aggregate monetary liability of Contractor [or Engineer] to the Employer under any theory (including without limitation breach of contract, tort, or statutory violation) shall be capped at the total value of US$ 1 million plus the proceeds of any available Project insurance.

Comments from Common Law Jurisdictions:

Australia: Limitations of liability are common in Australian construction contracts. They are, however, far from universal in common standard form contracts, even as an option for parties. The survey on which the 2014 national research report cited in relation to clause 1 was based found that, where a standard form construction contract is used, a limitation of liability clause is added 49% of the time, while a cap on liquidated damages is added 40% of the time.

In Australia, the model clause is likely to be effective to cap liability in respect of contract, tort and common law claims generally. There is clear authority on this point from the High Court: *Darlington Futures Ltd v Delco Aust Pty Ltd* (1986) 161 CLR 500, 510. Nonetheless, to the extent such a clause is ambiguous, it would be read contra proferentem, and the exclusion clause is unlikely to be allowed validly to extend to fraud.

The Australian Consumer Law provides the main threat to the effectiveness of the clause. First, the clause might be subject to the limited statutory prohibition on unfair contract. This susceptibility is, however, unlikely in major construction contracts, and the limitation arguably serves a legitimate purpose in any event, meaning it may not be unfair. A more substantial issue arises from section 18 of the Australian Consumer Law, which prohibits misleading or deceptive conduct in trade or commerce.

It is not possible to contract out of many critical aspects of liability under the Australian Consumer Law, including for misleading or deceptive conduct. It is thus doubtful that a party could cap its liability under it. Nevertheless, and surprisingly, this has not been authoritatively determined, and some decisions suggest it may be possible to impose a temporal limit on claims under the Australian Consumer Law. (*Firstmac Fiduciary Services Pty Ltd v HSBC Bank of Australia Ltd* [2012] NSWSC 1122.)

England: Clauses such as this are not uncommon, and if sufficiently clear in their terms are generally enforceable.

United States: "Limitation of liability" clauses cap the maximum monetary damage one party will pay when a claim arises. While such clauses are routinely enforced in contracts relating to "goods" under the Uniform Commercial Code, courts may limit their enforcement if they perceive them as requiring one party in effect to indemnify for the fault of another party. Such a result occurred in *City of Dillingham v. CH2M Hill Nw., Inc.*, 873 P.2d 1271, 1277–78 (Alaska 1994) (interpreting an Alaska anti-indemnity statute as prohibiting a cap on an engineer's liability). A similar result may arise in Wisconsin, where Wis. Stat. Ann. § 895.447 (West) states in part that: "Any provision to limit . . . liability . . . in connection with any contract . . . relating to the construction . . . is against public policy and void."

In the U.S., however, most states are likely to enforce limitation of liability clauses. Michael S. Zetlin & Francine M. Chillemi, *Building a Safe Haven: Clauses Imposing Monetary Limits on Designer Liability*, CONSTRUCTION LAW, January 2000, at 5. Some of those states have distinguished limitation of liability clauses from anti-indemnity causes and will enforce them as written. *Supra*; *see*, *e.g., Valhal Corp. v. Sullivan Assoc., Inc.*, 44 F.3d 195, 204 (3d Cir. 1995) (articulating a frequently cited test for validity: "Whether the cap is so minimal compared with the expected compensation, that the concern for the consequences of a breach is drastically minimized."). Other states may test the wording of a liability cap against the applicable anti-indemnification statute, state public policy, the relative bargaining power of the parties, and the reasonableness of language in the clauses. Mark J. Heley, *Professional or not: Should Courts Preclude Contract Limitations of Liability Solely Because of the Architect's or Engineer's Status as a Licensed Professional?*, 4 AM. C. CONSTRUCTION LAW. J., no. 1 (2010) (observing recent court decisions addressing limitation of liability clauses).

The American Society of Foundation Engineers (ASFE) has incorporated limitation of liability clauses into its standard engineer contracts. Heley, *supra*. Also, the International Federation of Consulting Engineers has issued a policy statement encouraging the use of limitation of liability provisions to protect professionals. Limitation of Liability Provisions, 6 BRUNER & O'CONNOR CONSTRUCTION LAW § 19:67, Westlaw (database updated December 2016).

Comments from Civil Law Jurisdictions:

Chile: Monetary caps on liability for the Contractor are usually enforced. Such caps do not apply to damages arising from willful misconduct or gross negligence.

Finland: Sample Clause 7 limits the Employer's entitlement to compensation to a defined sum plus insurance proceeds. It is not clear from the clause how the compensation cap refers to the contract price etc. Under the YSE conditions the parties' liability is almost unlimited: "unless otherwise provided for in the contract …each contracting party's liability shall include the obligation to compensate the other party for all loss or damage cause by the obligations under the contract…" "not, however, liable for loss or damage he could not have avoided…". The liability is, however, often contractually limited to the contract price, or to a percentage thereof.

The sample clause would be valid based on *pacta sunt servanda* and acceptable on the face of it. There are, however, limits to this; it would not be upheld in case of gross negligence on the part of the Contractor or Engineer. There are cases where the monetary cap has been set aside for different reasons.

In Supreme Court case 2003:26 (a church parish vs Consultant/supervisor firm) a mere reference by the Consultant/supervisor to general contract terms for consultants, where the liability was capped to the compensation for the work, was insufficient and SC found that the Consultant was liable for compensating the entire damage which was 5 x the cap (no gross negligence or intent was found in the case). Neither the compensation cap, nor an insurance reference were found having become part of the contract in spite of the reference. The case outcome highlights the need for information balance between the parties, perhaps also duty of loyalty, which could mean an obligation to inform the counterparty, and in particular an inferior party, of burdensome conditions.[Although not explicitly referred to, Section 36 of the Contracts Act, which seldom is used in B2B relations, may have played a background role here.]

In Supreme Court case 1999:80 an audit firm was held responsible for the entire damage caused by its deficient advice with regard to tax issues. Here again the obligation to inform and "know your customer" and find out was present; also reversed burden of proof, i.e. the Consultant was expected to show that it had not acted with negligence.

The acceptability of the Sample clause will depend on the facts of the case and balance between the parties etc. (likely the same for Sweden).

Netherlands: Sample Clause 7 limits the liability of the Contractor towards the Employer. Such a limitation of liability, in general, is accepted under Dutch Law. I refer to my remarks made with respect to Sample Clause 2. In most cases, Dutch courts are not likely to set aside a contract term that excludes or limits liability. Such clause may, however, be set aside if observance of such rule would be *unacceptable* given the standards of reasonableness and fairness (article 6:248 DCC).

The frequently used standard form of contract for Design & Build contracts, the UAV-GC 2005, provide for a limitation of liability for defects occurring after the actual date of completion and acceptance. According to paragraph 28 sub 3 of the UAV-GC 2005, the total damage to be compensated by the Contractor pursuant to the first section of this paragraph, shall be limited to 10% of the contract price in so far as that price is related to the realisation of the works by means of Design and Construction Work. If the amount thus calculated is less than EUR 1,500,000, the amount of damages due to the Employer shall total no more than EUR 1,500,000.

Most construction contracts in The Netherlands also provide for a limitation of liability with respect to delay damages. In the event that the date of completion and acceptance of the work is delayed due to circumstances attributable to the Contractor, the Contractor often forfeits a penalty for each and every day the acceptance is delayed. This penalty is considered to include all damages suffered by the Employer. Thus, in general, there are no grounds to claim additional damages beside the penalty forfeited. However, as mentioned before, a penalty clause may not be applicable insofar this, given the circumstances, would be unacceptable to standards of reasonableness and fairness. These standards may result in awarding additional damages, of in denying any penalty at all.

Sweden: Sample Clause 7 would be valid in Sweden as well where the Contractor's liability in AB is defined very differently from the Finnish corresponding conditions. Under AB a contractor's liability is limited at 15 % of the contract price or insurance proceeds if higher, indirect damages are excluded, but these limitations do not apply in case of intent or gross negligence.

In an arbitration award (known as the *Profilgruppen* case) the monetary cap was blown as the Consultant was found to have fundamentally violated the duty of care assigned to it (among other reasons). Contracts Act § 36 was applicable on this B2B case and the damages awarded were almost 10 times the Consultant's fee.

CLAUSE 8 – RESERVING UNILATERAL RIGHT TO CHOOSE DISPUTE RESOLUTION PROCESS

Sample: If any dispute arises between the parties that is not promptly resolved through mutual negotiation, the Employer shall have full discretion to decide whether that dispute is referred to adjudication in a binding arbitration or in a court of law in the country where the Project is located.

Comments from Common Law Jurisdictions:

Australia: Such a clause would be unusual in Australia. Standard form contracts in common use do provide for a tiered system of dispute resolution. Clause 47 of AS4300-1995 is one example. These standard forms do not, however, afford one party a right to make decisions about what dispute resolution mechanism will apply.

In Australia, the sample clause would raise a threshold question of interpretation. One interpretation seemingly open on the language is that the Employer has 'full discretion' to determine whether or not to refer a dispute to a method of resolution (whether arbitration or litigation). This interpretation threatens to amount to an ouster of jurisdiction and so is improbable. More likely, the clause would be interpreted so that, if a dispute had not been promptly resolved through mutual negotiation, the Employer would be obliged to refer that dispute to either arbitration or litigation. If the Employer did not do so, it would be in breach of contract.

Even if this second interpretation is preferred, there is a question as to whether the clause amounts to an enforceable reference to arbitration under legislation (for example the *Commercial Arbitration Act 2010* (NSW) or the *International Arbitration Act 1974* (Cth)). On balance, it is likely to be effective (see generally Julian Bailey, *Construction Law* (2nd ed, 2016), [25.41], and the English position in *NB Three Shipping Ltd v Harebell Shipping Ltd* [2005] 1 All ER (Comm) 200). To the extent the clause could not be enforced, the parties would be left to resolve disputes by litigation.

England: Probably, such a clause would be upheld.[19]

United States: Most arbitration clauses express a mutual agreement of the parties that disputes will be arbitrated. There are, however, some clauses giving one party a unilateral "option of demanding arbitration or insisting upon ordinary litigation." Hans Smit, *The*

[19] In *NB Three Shipping v Harebell Shipping* [2004] EWHC 2001 (Comm) the relevant clause was thus:

> 47.02 The courts of England shall have jurisdiction to settle any disputes which may arise out of or in connection with this Charterparty but the Owner shall have the option of bringing any dispute hereunder to arbitration….

That clause was effective, although not found to be open-ended and would cease to be available once the owners took a step in the action or otherwise led the charterers to believe on reasonable grounds that the option to stay would not be exercised

Unilateral Arbitration Clause: A Comparative Analysis, 20 AM. REV. INT'L ARB. 391, 393–94 (2009). Many U.S. are likely to enforce a unilateral arbitration clause, reading the Federal Arbitration Act broadly to preempt state rules challenging such clauses on grounds of public policy or unconscionability. Keith C. Philips, *Unilateral Arbitration Clauses: What Are They and Can They Be Enforced?,* http://watttieder.com/resources/articles/unilateral-arbitration-clauses-what-are-they (last visited Jul. 7, 2017); *see also THI of N.M. at Hobbs Ctr., LLC v. Patton*, 741 F.3d 1162, 1166-1169 (10th Cir. 2014) (analyzing the line of cases on FAA preemption and holding that unilateral arbitration clauses are not unconscionable because arbitration is not an inferior alternative to litigation). Under the FAA, state common-law rules "interfering with the fundamental attributes of arbitration" are preempted. *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 343 (2011).

Some courts, applying state law, have held that unilateral arbitration clauses are invalid because of unconscionability or the lack of mutuality. *See, e.g*., *Noohi v. Toll Bros., Inc.*, 708 F.3d 599, 609 (4th Cir. 2013) ("Under Maryland law, an arbitration provision must be supported by consideration independent of the contract underlying it, namely, mutual obligation."); *Figueroa v. THI of N.M. at Casa Arena Blanca, LLC*, 306 P.3d 480, 491 (N.M. Ct. App. 2012) (holding that non-mutual arbitration clauses are unconscionable and not preempted by the FAA). In addition, a few courts have adopted a fact-based approach and will decide the enforceability of a unilateral clause on a case-by-case basis. Richard Frankel, *Conception and Mis-Conception: Why Unconscionability Survives the Supreme Court's Arbitration Jurisprudence*, 2014 J. DISP. RESOL. 225 (2014).

Even if a unilateral arbitration clause is ultimately enforceable, it may be challenged if the party who holds the option fails to invoke it promptly.

Comments from Civil Law Jurisdictions:

Chile: Unilateral decisions regarding dispute resolution process are generally not enforceable. The choice of venue may be left to the unilateral decision of the plaintiff in case of non-exclusive jurisdiction clauses.

Finland: Sample Clause 8 gives the Employer a unilateral right to choose dispute resolutions. This is very different from Finnish practice, where these provisions are mutually agreed or pre-agreed in the general conditions. YSE assume that disputes would be resolved in a District Court, unless arbitration has been agreed.

The sample clause offers great opportunity to exploit the situation when an issue arises. Its acceptability will depend on the facts of the case and the position of the parties.

Netherlands: Sample Clause 8, can be regarded as a unilateral arbitration clause. It is the Employer who is entitled to decide whether to opt for arbitration or not. With reference to my remarks regarding sample Clause 5, a unilateral arbitration clause may be invalid in a

contract with a consumer, based on the Directive 93/13/EEC of the European Union, dated 5 April 1993, protecting consumers from unfair terms in contracts.

In his article in the Dutch magazine for International Civil Law (‘*Nederlands Internationaal Privaatrecht, NIPR, 2017/1*), Mr. B. van Zelst noted that (unilateral) option arbitration clauses as such are not prohibited under Dutch Law. It will depend on the circumstances of the case, whether or not these clauses are legitimate. One aspect that has to be taken into consideration, is the equality of arms. In his article, Mr. Van Zelst states that there is no specific case law yet regarding these option arbitration clauses. In 1997, the Supreme Court decided in a case where parties had agreed to arbitration, but one of the parties had the right to initiate legal proceedings with the competent court in deviation of the arbitration clause (*HR March 21, 1997, ECLI:NL:HR:1997:AG7212, NJ 1998/219, Meijer/OTM*). Although this is the mirror image of sample Clause 8, the Supreme Court had no objections to such clause.

Sweden: It is questionable whether Sample Clause 8 would be enforceable in Sweden; very balanced and special conditions would be required for its applicability. Under Swedish law there are quite strict requirements on how the choice of dispute resolution proceedings can validly be incorporated as illustrated by case law below.

The principal rule according to AB is that disputes are solved in a District Court if the sum in dispute does not exceed a specified amount. If it exceeds the specified amount, it will be decided through arbitration.

NJA 1979 s. 666 concerned a clause according to which all disputes concerning the contract shall be decided according to Swedish law or through arbitration. The issue concerned the applicability of Contracts Act § 36 and the Supreme Court noted that arbitration clauses can hinder the weaker part of getting justice due to economical circumstances. This can in itself be unreasonable.

The clause was “hidden” in the documents and not raised in the contract negotiations.

Due to the above and certain other circumstances the clause was set aside.

In NJA 1987 s. 639 a party had claimed that the arbitration clause in the contract was unreasonable due to its inferior position in the contractual relationship. Also this case concerned the applicability of 36 § of the Contracts Act to an arbitration clause B2B. The fact that one party stated that it could not comprehend the arbitration clause was not enough to set aside the clause. The decision was impacted by the inferior position of the party in question, and the court decided that the B2B relationship was unequal and that 36 § was applicable.

CLAUSE 9 – CONTINUING WORK DESPITE PENDING DISPUTE

Sample: The existence of a pending dispute between the parties shall not excuse Contractor from continuing to work diligently on the Project, provided that the Employer continues making payments of undisputed sums as the Work is performed.

Comments from Common Law Jurisdictions:

Australia: Clauses substantially similar to the sample clause are commonly included expressly in Australian standard forms (see, e.g., clause 47.1 of AS4300-1995 and clause 15.15 of PC-1 1998).

England: There is no apparent reason why such a clause should be ineffective.

United States: "Continuing work despite dispute" clauses are generally enforceable in the United States. The clauses typically require Contractors to proceed with performance even if the parties dispute the value or scope of the work. SMITH, CURRIE & HANCOCK LLP, SMITH, CURRIE & HANCOCK'S COMMON SENSE CONSTRUCTION LAW: A PRACTICAL GUIDE FOR THE CONSTRUCTION PROFESSIONAL 200 (4th ed. 2009) (cautioning Subcontractors to preserve right to proceed under protest). The AIA Documents and the FAR impose similar obligations on Contractors to continue performing pending final resolution of claims. AIA A201-2007, General Conditions § 15.1.3; FAR § 52-233.1(i). An Employer may, however, lose its right to require continuing work if it fails to make undisputed payments, which would constitute a material breach of the contract. *See*, *e.g.*, *Framingham Heavy Equip. Co. v. John T. Callahan & Sons, Inc.*, 807 N.E.2d 851, 857 (Mich. Ct. App.2004) (noting that "continuing work despite dispute" clause did not require the Contractor "to continue working without being paid"). The "continuing work" clause might also be challenged if the Employer is asking a Contractor to implement large and fundamental changes in the work without authorizing any reasonable payment.

Some U.S. courts have enforced these clauses even when an Employer has materially breached the contract. *See*, *e.g.*, *Recon/Optical, Inc. v. Gov't of Israel*, 816 F.2d 854, 857 (2d Cir. 1987) ("A provision applicable only to non-material breaches would be superfluous, because Recon's obligation to continue performance would not be legally diminished by such a breach even absent the clause.") (citing A. Corbin, CORBIN ON CONTRACTS § 946 (1951 & Supp.1971)). Other courts, including the Court of Appeals for the Federal Circuit, have recognized that a non-breaching party may stop work when facing a material breach by the other party. Christopher M. Burke & Alex W. Dockery, *Living in a Material World: Kiewit-Turner, Material Breach, and Implications for Breaching and Nonbreaching Parties*, 35-SPG CONSTRUCTION LAW. 18 (2015) (commenting on the Civilian Board of Contract Appeals decision in *Kiewit-Turner* and summarizing actions available to the nonbreaching parties to continue performance without waiving the right to be excused); *Kiewit-Turner, A Joint Venture*, 15-1 BCA P 35820 (2014).

While continuing to perform work under dispute, a U.S. Contractors may be able to file a lawsuit asking a court to issue a declaratory judgment to confirm that they are not required to move forward until the dispute is resolved. Many U.S. courts may, however, refuse to grant such relief where the contractors have "specifically undertaken obligation[s] to perform that work and postpone any claim." *Kalisch-Jarcho, Inc. v. City of New York*, 533 N.E.2d 258, 261 (N.Y. 1988) (holding that a declaratory judgment was inappropriate to resolve disputes before contract completion). A Contractor may nonetheless prevail if it can demonstrate "a special need for early resolution of this issue" exists. Burke & Dockery, *supra*.

Comments from Civil Law Jurisdictions:

Chile: This would be a valid provision in Chile, enforceable under its clear terms.

Finland: Sample Clause 9 is likely to be enforced under freedom of contract and the YSE general terms and conditions actually cover a similar situation *i.e.* the Contractor must complete works at the request of the Employer.

Netherlands: A clause such as Sample Clause 9, is probably enforceable under Dutch Law, given the freedom of contract. A frequently used model form of contract, the Uniform Administrative Conditions for the Execution of works and Technical Installation Works 2012 ('UAC 2012'), provides for a specific clause regarding the continuation of work. According to paragraph 50 of the UAC 2012, pending an award in the dispute the Contractor shall be required, if the Employer's agent so demands, to continue working in accordance with the instructions of the Employer's agent, unless otherwise decided by the Board of Arbitration in proceedings in an 'urgent dispute' and without prejudice to the Contractor's rights which may result from the award. Insofar as payment of any installment should suffer delay in connection with any dispute pending in arbitration, the Employer shall make such payment as is appropriate in view of the progress of the works and the respective claims of the parties, according to paragraph 50 sub 2.

Sweden: Such a clause is likely to be enforced under freedom of contract, although there is no explicit provision to that effect in AB.

CLAUSE 10 – REQUIRING WRITTEN DIRECTION PRIOR TO PERFORMING CHANGED WORK

Sample: If the Contractor claims additional compensation or time based on an Employer Variation, Contractor shall not be entitled to either of those remedies unless the Employer has first issued a written direction requiring or authorizing such Variation.

Comments from Common Law Jurisdictions:

Australia: Given the potential for disputes over whether a direction by the Employer constitutes a variation (thereby, in most cases, entitling the contractor to additional time and cost), Australian standard forms tend to carefully delineate the process for the generation of variations by the Employer. Thus, for example, clause 40.1 of AS4300-1995 provides, along the lines of the sample clause, that the Contractor 'shall not vary the work under the Contract except as directed by the Superintendent or approved by the Superintendent pursuant to Clause 40.'

For reasons akin to those discussed in relation to sample clause 4 above, the element of the sample clause which purports to deny the Contractor additional time and cost is potentially more problematic, at least to the extent that the work is, in fact, a change to the contracted workscope. Nonetheless, the starting point is that a clearly drafted clause, establishing that the risk of work done without provision of a direction lies with the contractor, may be expected to be enforced according to its terms.

England: See under Clause 4 above for the wide range of potential arguments that the Contractor might have available to circumvent a clause such as this.

This sample clause might be circumvented, at least as to money, if the Employer makes an oral request for what is clearly additional work which the Contractor complies with, but refuses to confirm that request by the issue a written direction: the Contractor could say that since the contract disavows governance of the entitlement to payment for such work, the way is open for the Contactor to obtain payment by way of a restitutionary quantum meruit.[20] In practice, clauses like this are usually more sophisticated, as Employers seek to anticipate and shut down such alternative routes to payment. Alternatively, one of the other circumvention avenues such as estoppel might be available.

United States: U.S. courts may enforce clauses requiring written variation orders (aka "change orders") as prerequisites for a Contractor's right to be paid for a variation. When an Employer directs a change and later refuses to pay for the technical reason that it did not issue

[20] Although the courts are somewhat cautious here: in *Pan Ocean Shipping Ltd v Creditcorp Ltd* [1994] 1 WLR 161 at 166 Lord Goff said:

> It is always recognised that serious difficulties arise if the law seeks to expand the law of restitution to redistribute risks for which provision has been made under an applicable contract

a written order, however, a U.S. court may find that the Employer waived its right to enforce the clause. The range of potential results is discussed in 1A Bruner & O'Connor on Construction Law, § 4.37 (December 2016).

The case law in the State of California illustrates some of the potential variations in outcome. There, the enforcement of clauses requiring written change orders may depend on whether the contract is public or private. In private contracts, parties can waive or modify the contract requirement by their actions. *See, e.g., Howard J. White, Inc. v. Varian Associates*, 178 Cal. App. 348, 353 (1960) (oral instructions established a waiver of the requirement for a written variation order). However, California courts have held that a similar provision in a public works contract cannot be waived or modified. *See, e.g.,* G. *Voskanian Const., Inc. v. Alhambra Unified School District*, 204 Cal. App.4th 981, 988-991 (2012) (concluding that a requirement for written change orders could not be waived or orally modified in a public contract); *P&D Consultants, Inc. v. City of Carlsbad* (2010), 190, Cal. App.4th 1332. 1335 (2010) ("Unlike private contracts, public contracts requiring written change orders cannot be modified orally or through the parties' conduct."). Thus, a Contractor working on a private project may be able to recover for work not authorized by a written order if ir can show that the conduct or communications by the parties constituted a waiver or modification, while a Contractor working on a public contract may be unable to do the same.

Comments from Civil Law Jurisdictions:

Chile: This sample clause is enforceable in Chile, but it will find the usual limitations in case there is lack of good faith by the Employer (i.e. it creates a legitimate trust on the Contractor by requesting a variation orally and then refuses to put it in writing). In practice, the Contractor will not perform any works or incur in additional costs in relation to variations that have not been requested as the agreement requires.

Finland: Sample Clause 10 is likely to be enforceable in Finland.

The Supreme Court has in case KKO 2008:19 referred in 4 above ruled that the Contractor had forfeited its entitlement to claim compensation for change/variation works when it had not met the required form for applying compensation and time extension even though a waiver clause was not included in the YSE general terms and conditions. This was the first time the Supreme Court evaluated the formal procedure for applying for extension of time and compensation, and the decision has clarified Finnish law on this point. The decision bases on the reasoning that the Employer should be entitled to know in advance the costs of the change, remedy work, extension of time etc. in order to make informed decisions. The decision shows a strict approach towards the contractor, i.e. that the Contractor must present its claims without delay with the risk otherwise of losing its entitlements. The Supreme Court did not recognize the informal site practice between the parties as ground to set aside the agreed notification requirement (ref. Case commentary by Antti Järvinen and Kimmo Heikkin en in Lakimies 6/2008 p 981-1002).

Netherlands: Clauses that require a written change order prior to commencing with the variation, are common in The Netherlands.

With respect to additional work, article 7:755 DCC, stipulates that in the event that the Employer has asked for additives or changes in comparison to the agreed work, the Contractor may only then demand an increase of the agreed price when he has given timely notice to the Employer that this will necessarily lead to a price increase, unless the Employer should have understood of his own accord that such an increase would necessarily result from this.

It should be noted, however, that it is standing case law of the Arbitration Board for the Building Industry that the lack of a written change order does not forfeit the right of the Contractor for reimbursement of such additional work (*for example Arbitration Board for the Building Industry, September 22, 2009, arbitration number 29.355* and the case law mentioned in *'Hoofdstukken Bouwrecht, deel 5, Van Wijngaarden/Chao-Duivis, nr. 242'*).

If a written variation order is required, as a general rule, the Contractor is not obliged to execute the change order as long as he has not obtained this written approval (*see Arbitration Board for the Building industry, appeal, September 13, 2006, arbitration number 70.980*).

Sweden: Sample Clause 10 is likely to be enforceable in Sweden as well, albeit the general conditions (= construction practice) include a reservation for the event the sanction would be unreasonable.

Variations and changes require a written direction under AB.

Variations or changes that have been made without the Employer's direction do not entitle the Contractor to additional compensation, *if such a sanction is not unreasonable.* When assessing what is unreasonable one can look at the comment on the paragraph. The first example given is when the Employer informs the Contractor that the Contractor's suggested work is not relevant. If the Contractor then proceeds to do the work and the Employer after all is satisfied, the Contractor shall receive compensation. The second example is when immediate action need to be taken and there is no time to inform the Employer.

The Contractor must under AB without delay obtain the Employer's opinion if there is a risk that the variation will cause the contract price will be exceeded.

CLAUSE 11 – EMPLOYER DISCLAIMER OF GEOTECHNICAL INFORMATION

Sample: Employer has disclosed certain subsurface test borings and other geotechnical data for Contractor's consideration in preparing its bid tender proposal. Employer shall not, however, have any liability for errors or omissions in that information, and Contractor shall not be entitled to additional compensation or an extension of Contract Time on the ground that actual Site conditions may vary from those indicated in the Employer's geotechnical information.

Comments from Common Law Jurisdictions:

Australia: At common law, the Contractor bears the risk of ground conditions, at least up to the point that unexpected conditions frustrate the contract. (*Thiess Services Pty Ltd v Mirvac Queensland Pty Ltd* [2006] QCA 50, [34.]) Given this potentially harsh common law risk allocation, latent conditions clauses are carefully negotiated. Often, the Contractor bears all risk except for latent conditions that a competent Contractor would not have anticipated at the time of tender (or some variation on this formulation).

In addition to the common law and contractual risk allocation, the prohibition on misleading or deceptive conduct in section 18 of the Australian Consumer Law is vital. As noted above, it is not possible to contract out of this liability.

On the face of it, the Employer could be liable for its misleading or deceptive conduct notwithstanding the clause. This liability might arise because the Employer's subsurface tests and other data were actively misleading, or because relevant information was omitted. This misleading or deceptive conduct could give rise to a right to statutory damages (among other remedies). These damages, however, rely on the Contractor having suffered loss 'because of' the misleading or deceptive conduct (see section 236).

An Australian form of the model clause would typically seek to break the connection between the misleading conduct and the loss. This is normally done through extensive disclaimers and through warranties from the Contractor that it has relied only on its own investigations, and not on the Employer's information. Even extensive drafting may not be sufficient for the Employer to avoid liability: *Abigroup Contractors Pty Ltd v Sydney Catchment Authority (No 3)* (2006) 67 NSWLR 341. Whether the drafting is effective depends on several factors such as the precise language used, the relative expertise of the parties, the degree of negotiation and the Contractor's ability to conduct its own tests. (See generally *Butcher v Lachlan Elder Realty Pty Ltd* (2004) 218 CLR 592.)

England: A statement of fact by the Employer as to the nature of the soil, or the site or the like is often made in the tender documents, and is at that stage a representation. An Employer who induces a Contractor to enter into the contract by such a representation, if inaccurate, is liable for damages under the Misrepresentation Act 1967 unless he proves that

he had reasonable ground to believe and did believe up to the time the contract was made the facts represented were true. Any attempt to contract out of such liability is ineffective unless it satisfies the requirement of reasonableness as stated in section 11(1) of the Unfair Contract Terms Act 1977[21].

This clause is, in effect, an attempt to contract out of liability for misrepresentations. The burden of proving the clause is reasonable (so as not to fall foul of the Unfair Contract Terms Act 1977) lies on the person relying on it. A clause is likely to be reasonable and enforceable where it is clear[22] and in a contract between sophisticated commercial parties.[23] The courts recognise that such clauses may properly reflect the commercial allocation of risk agreed between the parties.[24]

However, where such a clause is unreasonable, it will be unenforceable, and the Misrepresentation Act 1967 will apply. The usual measure of damages under the Act is different from the measure applicable to breach of warranty claims, such that instead of equating to the cost to the Contractor of coping with those errors or omissions in the information, damages equate to the cost consequence to the Contractor of entering into the contract at all. Thus, in the case of disastrously unprofitable contract, the damages obtainable under the Act might be much more than any likely contractual recovery. Further, damages under section 2(1) of the Misrepresentation Act are assessed on the fraudulent measure[25], i.e. the recoverability is not limited by the usual test of foreseeability[26].

It is worth noting that decided cases under the Misrepresentation Act 1969 relating to geotechnical data are surprisingly rare in English law[27]: there are rather more comparable cases in other common law jurisdictions.

United States: If performance of a project depends on the nature or characteristics of materials in the ground, it is difficult and sometimes impossible for a Contractor to prepare a fixed price tender without relying on some sort of pre-contract indication as to the existing conditions. Such information is often provided in the form or test borings, soil samples, or a geotechnical baseline report. While contracts often promise additional compensation for site conditions that differ materially from those indicated in the contract documents, some Employers attempt to disclaim responsibility for errors or omissions in the geotechnical information that they provide to bidders. One leading treatise has noted that the enforcement

[21] Section 3
[22] See *Ravennavi SpA v New Century Shipbuilding Co Ltd* [2006] 2 Lloyd's LR 280 for an example of a clause that we not sufficiently clear to exclude liability for misrepresentation.
[23] See *Persimmon Homes Ltd v Ove Arup and Partners Ltd* [2017] EWCA Civ 373 and *Transocean Drilling UK Ltd v Providence Resources* [2016] 2 All ER (Comm) 606.
[24] See for example *Mowlem Plc v Newton Street Limited* (2003) 89 Con LR 153.
[25] *Royscot v Rogerson* [1991] 3 WLR 57.
[26] *Smith New Court Securities v Scrimgeour Vickers* [1997] AC 254.
[27] The decisions in *Mowlem v Newton Street* [2003] EWHC 737 (TCC) and *Fitzroy Robinson Ltd v Mentmore Towers Ltd* [2009] EWHC 1552 (TCC) concern misrepresentation in construction cases in different contexts.

of such disclaimers is likely to be "circumscribed by a number of basic principles focusing on the fair treatment of contractors". 4A Bruner & O'Connor on Construction Law, at § 14:34. In *Metcalf Construction Co., Inc. v. United States,* 742 F.3d 984 (Fed. Cir. 2014), the U.S. Navy attempted to avoid responsibility for errors in its geotechnical data by stating that its soil report was "for preliminary information only". The Court of Appeals for the Federal Circuit nonetheless held that the Contractor was entitled to rely on the Navy's information, saying that the government disclaimer had to be "read against the longstanding background presumption against finding broad disclaimers 'of liability for changed conditions'" 742 F.3d at 996. In *Condon-Johnson & Associates, Inc. v. Sacramento Municipal Utility Dist.,* 149 Cal.App.4th 1384 (2007), the California Court of Appeals noted that "a general disclaimer could not overcome positive assertions of fact regarding subsurface conditions upon which the contractor was entitled to rely," 149 Cal.App.4th at 1396, which was reinforced by section 7104 of the California Public Contract Code (requiring equitable compensation for a differing site condition on public contracts). Similarly, a New York court held that a disclaimer of conditions "on, about or above the site" did not protect the Employer against a claim for differing subsurface conditions, especially where the contract included a Changed Conditions clause. *Andrew Catapano Co., Inc. v. City of New York,* 116 Misc. 2d 163, 165, 455 N.Y.S.2d 144 (Sup 1980). In other words, an Employer who provides subsurface information as a basis for bids is unlikely to enforce a clause disclaiming responsibility for that information if a Contractor reasonably relies on it.

Comments from Civil Law Jurisdictions:

Chile: This would be a valid and enforceable provision in Chile, provided that the Employer does not act with willful misconduct or gross negligence.

Finland: Sample Clause 11 limits the Employer's liability for site information. Under YSE the Employer would be liable for the information he provides to the Contractor. Clauses limiting the Employer's liability or assigning it to another party, are not prohibited, but interpretation and enforceability can be problematic. The result will depend on the facts of the case, and the answers to the following questions may be relevant: What is the Employer's knowledge or the quality of the site information? Does the new found "hidden" information lead to a substantial change in the works or the completion schedule, etc.? Clearly the Employer would have an obligation to explicitly inform the bidder/Contractor about any information which may impact adversely on the Contractor's works and of which he is aware (based on the duty of loyalty etc.).

Netherlands: A disclaimer from the Employer of geotechnical or other information provided to the Contractor is not uncommon in The Netherlands. As already mentioned when discussing previous sample clauses, whether this disclaimer will be upheld in court or arbitration may depend on the question if, given the circumstances, this would be acceptable to the standards of reasonableness and fairness.

The most frequently used model forms of contract in The Netherlands, the UAC 2012 and the UAV-GC 2005, state that the Employer is liable for the information submitted. For example paragraph 5 sub 2 of the UAC 2012 state that the Employer shall be responsible for the constructions and construction methods prescribed by him or on his behalf, including the effect that soil conditions may have on such constructions and construction methods, as well as for the instructions and directions given by him or on his behalf. Paragraph 29 sub 3, furthermore states that the Employer shall in any event be responsible for the accuracy of the data supplied by him or on his behalf.

In a similar way, paragraph 3 sub 2 of the UAV-GC 2005 states, in short, that the Employer is responsible for the contents of all information he provided to the Contractor as well as for the goods put at the Contractor's disposal pursuant to this paragraph.

In order to avoid liability according to one of the clauses mentioned above, some employers tend to write in their specifications that they only submit data for information purposes. It could be argued, that even under those circumstances, the employer is also responsible for the correctness of data provided for information purposes only (*see Arbitration Board for the Building Industry,* August 21, 2007, TBR 2008, page 654 and *'UAV-GC 2005, Over problemen bij het werken met geintegreerde contracten',* Mr. R.G.T. Bleeker, IBR 2016, page 24)

Sweden: There is no reason to believe that the comment for Sweden would be different from what has been noted about Finland. The obligation for inform the counterparty is strictly applied based on the duty of loyalty.

CLAUSE 12 – CONTRACTOR ASSUMES RISK OF DELAYED PERMITS

Sample: Contractor shall be responsible for obtaining all required local government permits for its excavation and above-ground construction work at the Project Site. Unexpected costs incurred in obtaining such permits (including without limitation any costs arising from slow issuance of such permits) shall be a Contractor risk, and Contractor shall not be entitled to claim additional compensation associated with problems encountered with obtaining the required permits.

Comments from Common Law Jurisdictions:

Australia: The 'Abrahamson principles' – especially, that a risk is most efficiently allocated to whichever party is best able to control and manage it – continue to have resonance in Australian contract drafting and negotiation, and have underpinned the drafting of standard forms such as AS4000-1997.

Therefore, whilst it is possible as a matter of contractual risk allocation that the Contractor bears the risk of obtaining such permits, it would in our experience be unusual for

the Contractor to be willing to do so in unfettered terms. Rather, and consistent with the Abrahamson principles, the Contractor might be subject to an express obligation to use its best endeavours to obtain such permits, but entitled to an extension of time (but not cost relief) to the extent it has discharged that obligation yet the issue of the permits is delayed beyond a certain point.

On a related note, Australian standard forms tend to provide the Contractor with an extension of time for changes in legislative requirements after the contract is entered into (see, e.g., clause 35.5(b)(v) of AS4300-1995).

England: In principle, risk allocation clauses like this are effective. The position might be different if the Employer is itself the local government agency which issues such permits.

United States: It is not unusual for Employers on public or private projects to assign responsibility for project permits to the Contractor. On U.S. government contracts, for example, section 52.236-7 of the Federal Acquisition Regulation provides in part that "The Contractor shall, without additional expense to the Government, be responsible for obtaining any necessary licenses and permits, and for complying with any Federal, State, and municipal laws, codes, and regulations application to the performance of the work." This "Permits and Responsibilities" clause was tested in *Bell/Heery JV v. United States,* 739 F.3d 1324 (Fed. Cir. 2014), where an earthwork Contractor planned on getting a permit that would allow its cut-to-fill operation to occur in a single step. Instead, the local New Hampshire permitting authority would only allow the Contractor to disturb up to 40 acres of land at one time, adding a number of other unexpected requirements that increased the cost and time of the cut-to-fill process. The majority decision of the Court of Appeals for the Federal Circuit nonetheless held that the Contractor assumed the risk of unexpectedly burdensome permit requirements. In his dissenting opinion, Circuit Judge Mayer argued that the majority "places undue weight on the Permits and Responsibilities clause" and that the Government (Employer) may have owed an "independent obligation" to assist the Contractor by meeting with local permitting authorities in New Hampshire. 739 F.3d at 1338 (citing cases limiting the Permits and Responsibilities clause). Even if a contract assigns responsibility for permitting to a Contractor, unexpected delays or other obstacles in the permitting process may entitle a Contractor to relief under theories of *force majeure*, frustration of contract, or mutual mistake.

Comments from Civil Law Jurisdictions:

Chile: This seems like a regular allocation of risk between the parties to a contract and therefore will be very likely upheld in Chile.

Finland: Sample Clause 12 would be within the freedom of contract, but the enforceability would *inter alia* depend on which party would be obliged or entitled to apply for the permits (Employer or Contractor) under the applicable law and that party's possibility to control the process. YSE assume that the Employer acquires the permits required for construction. If the Employer controls the process the questions include *inter alia*: has the

Employer acted diligently and on its part fulfilled the requirements for the permit etc.? If not, the clause may not be enforceable. Again, if the delay associated is on the part of the governmental authority or the Contractor (assuming it would have a role to play), then the clause would be enforceable. For permits which the Employer's input is material and which the Employer formally would seek, the set up seems quite arbitrary and possibly alien to a natural risk division between the parties (responsibility for events outside its control). Hence such a clause may be subject to Contracts Act section 36 scrutiny.

Netherlands: Under Dutch law, a contract clause imposing the risk with respect to permits upon the Contractor, would be within the freedom of contract. The Uniform Administrative Conditions for the Execution of Works and Technical Installation Works 2012 ('UAC 2012'), provide for a division in responsibilities with respect to obtaining permits and approvals. According to paragraph 5 sub 1-a, the Employer shall ensure that there shall be at the Contractor's disposal in good time, amongst others, all permits pertaining to private or public law required for the work as planned in accordance with the specification. Based on paragraph 6 sub 10, the Contractor shall obtain in due time the permits pertaining to private or public law which he may need or desire, insofar as these are not included among the permits to which the Employer shall attend according to the provisions of paragraph 5. In general, this means that the Employer is responsible for obtaining a building permit and other permits that are necessary to realize the work, whereas the Contractor is responsible for obtaining the permits needed to erect the work, for example a permit needed for the use of certain construction equipment.

The Uniform Administrative Conditions for Integrated Contracts 2005, ('UAV-GC 2005'), stipulates in article 6 of the Model Agreement Form, that annex I of the agreement shall list those permits, approvals et cetera, which need to be obtained by the Employer. All permits, approvals, et cetera that are not mentioned in this annex, need to be obtained by the Contractor. The UAV-GC 2005 provide for a comprehensive set of rules to further determine the liabilities of parties in the event that a permit is not, or not timely, being issued.

Given the freedom of contract principle, parties are generally at liberty to deviate from the provisions of these standard contract forms.

It needs no saying that risk allocation in general is not to be taken lightly, as has been illustrated by the Highway A-15, Maasvlakte-Vaanplein, project. A project aimed at widening a stretch of 37 kilometer highway near the port of Rotterdam. Due to an alleged increase of budget by more than 300 million euros, a large construction company, Ballast Nedam, nearly went bankrupt. The dispute with the Dutch government was finally settled at the end of 2015, and let to questions in Dutch parliament as to whether the government shifted too much risk towards the Contractors.

ISSUE 13: IMPLIED DUTY OF GOOD FAITH:

Will courts or arbitrators imply a duty of good faith between the parties that:

(a) is considered when interpreting a contract clause, or

(b) may effectively add an obligation that was not expressly stated in the contract

or

(c) may result in an express contract term not being enforced

Comments from Common Law Jurisdictions:

Australia: The High Court of Australia has not finally determined whether the common law of Australia recognises an implied duty of good faith.

Some intermediate appellate authority suggests a duty of good faith and reasonableness will be recognised as a term implied by law in all contracts in a particular class — perhaps in all commercial contracts. (*Burger King Corporation v Hungry Jack's Pty Ltd* [2001] NSWCA 187, [164].) Most recent authority tends to be less enthusiastic, though the NSW Court of Appeal in particular continues to suggest that an implied duty of good faith has some role, most recently in the context of the prevention principle: *Probuild Constructions (Aust) Pty Ltd v DDI Group Pty Ltd* [2017] NSWCA 151, [128]. Outside particular contexts like franchising arrangements, the best view is probably that a duty of good faith will only arise where it is implied in fact in a particular contract. (*Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL* [205] VSCA 228, [25].)

Despite this, standard form contracts, the common law and statute may provide similar protection in some circumstances. In standard form contracts, the Employer is often obliged to ensure that the superintendent acts honestly and fairly (or to some equivalent standard). (See clause 23 of AS4300-1995). Some standard form contracts have sought to impose more explicit duties to act in good faith. The most notable example is AS11000, a draft contract intended to replace two of the standard forms most commonly used in Australia. It would have required the parties to act 'reasonably in a spirit of mutual trust and cooperation, and generally in good faith towards the other'. At the time of writing, development of this draft standard form has stalled.

At common law, an implied duty to cooperate will be readily recognised (*Secured Income Real Estate (Aust) Ltd v St Martins Investments Pty Ltd* (1979) 144 CLR 596), and a duty to act reasonably may be implied in respect of some contractual decisions (*Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234).

The Australian Consumer Law is the main relevant legislation. It prohibits unconscionable conduct within the scope of the legislation (section 20). As noted above, in limited circumstances, it also renders unfair contract terms void.

England: In English law, there is no principle of interpretation or implication, as a matter of law, of any generalised duty of good faith in construction contracts[28]. Duties similar to duties of good faith arise in very narrow circumstances, when a party has a fiduciary power over the interests of another.[29] However, there are signs that English law is becoming more receptive to concepts of good faith, and in it was said in *Yam Seng PTE Ltd v International Trade Corporation Ltd*[30] that there is no difficulty in implying a duty of good faith as a matter of fact. Implication of terms in fact is unlike implication of terms in law, in that the particular circumstances need to be considered. A long-term contract requiring cooperation is more fertile territory than a short-term arms-length deal.

The narrow category of similar duties recognised in English law arise, in the context of a construction contract, in relation to a particular obligation, rather than as applicable to all obligations arising under a contract. Thus for example, where a power is conferred by a contract on one party to make decisions which affect them both it must be exercised honestly and for the purpose for which it was conferred, and must not be exercised arbitrarily, capriciously or unreasonably (in the sense of irrationally).[31]

In the recent decision in *Costain Ltd v Tarmac Holdings Ltd*[32], Coulson J endorsed what was said in *Keating on NEC3* (First Edition 2012) at paragraph 2-004:

> 1. What is good faith will depend on the circumstances of the case and the context of the whole contract.
>
> 2. Good faith obligations do not require parties to put aside self-interests; they do not make the parties fiduciary.
>
> 3. Normal reasonable business behaviour is permitted but the court will consider whether a party has acted reasonably or unconscionably or capriciously and may have to consider motive.
>
> 4. The duty is one 'to have regard to the legitimate interests of both the parties in the enjoyment of the fruits of the contract as delineated by its terms.'

United States: According to the Restatement of Contracts (2d), "[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement." RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981). In the U.S., this duty is applied in many different ways. In contracts for the sale of goods, the duty of good faith is implied by Article 1-203 of the Uniform Commercial Code (UCC). In contracts for construction services, the

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[28] *Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd (t/a Medirest)* [2013] EWCA Civ 200. There are other types of contract, such as partnership agreements, where there is such an implication.

[29] In *Re Armstrong* (1886) 17 QBD 521 at 531, Fry LJ defined a power as "an individual personal capacity of the donee of the power to do something". See more generally The Law Commission of England & Wales, Fiduciary Duties of Investment Intermediaries (No 350, 2014) paras 3.44 – 3.65.

[30] [2013] EWHC 111 (QB)

[31] Ibid at [145*]; Abu Dhabi National Tanker Co v. Product Star Shipping Ltd (The "Product Star")* [1993] 1 Lloyd's Rep 397, 404; *Socimer Int'l Bank Ltd v Standard Bank London Ltd* [2008] 1 Lloyd's Rep 558, 575-7.

[32] [2017] EWHC 319 (TCC)

good faith duty has been described as requiring each party to refrain from interfering with the other party's contract performance, and mandating that parties avoid acting "so as to destroy the reasonable expectations of the other party regarding the fruit of the contract." *Centex Corp. v. U.S.,* 395 F.3d 1283, 1304 (Fed. Cir. 2005). The duty of good faith has been read into public as well as private construction contracts. 3 PHILIP L. BRUNER & PATRICK J. O'CONNOR, JR., BRUNER & O'CONNOR CONSTRUCTION LAW § 9:103.

To some extent, U.S. courts have applied the duty of good faith to imply an additional obligation that was not expressly stated in the contract. A decision by the U.S. Court of Appeals for the Federal Circuit, *Metcalf Const. Co., Inc. v. U.S.,* 742 F.3d 984 (Fed. Cir. 2014), is often cited as providing an expansive view of the duty of good faith in federal construction contracts. In that case, the court held that "a breach of the implied duty of good faith and fair dealing does not require a violation of an express contract provision." *Id.* at 994. U.S. courts have also found a violation of the implied duty of good faith when one party performs in a manner that is unfaithful to the purpose of the contract, thereby undercutting the justified expectations of the non-breaching party. 23 RICHARD A. LORD, WILLISTON ON CONTRACTS § 63:22 (4th ed. 1990). Although *Metcalf* leaves room for finding a breach of the implied duty of good faith even if there is no explicit corresponding contractual obligation, the Federal Circuit has refused to find a breach of the duty of good faith when the contract expressly permits the action being challenged. *Century Exploration New Orleans*, LLC v U.S., 745 F.3d 1168, 1179 (Fed. Cir. 2014). Thus, although it is possible that additional obligations may be read into the contract, the implied duty of good faith probably cannot be used to bar enforcement of an expressly stated contractual duty.

Many state courts have found a similar limit to the implied duty of good faith and they have refused to allow the duty to negate a specific contract provision. *See Sanders v. FedEx Ground Package Sys., Inc.,* 144 N.M. 449 (2008); *Agrecycle, Inc. v. City of Pittsburgh*, 783 A.2d 863 (2001).

Comments from Civil Law Jurisdictions:

Chile: Under Chilean law, contracts must be complied with and enforced in good faith and one of the main principles that a court must consider when interpreting unclear passages of a contract is good faith. However, it is very unlikely that a court departs too much from the clear words of the agreement, such as in the examples above. When there is a confusing or unclear part of the agreement, courts may interpret them using the good faith principle, which may result in modifying or setting obligations that where not clearly stated in the contract, but is very unlikely that the court imposes obligations that do have a direct connection with the actual wording of the agreement

Finland: The answer is yes to both a) and b) based on the duty of loyalty (which is the Nordic version of good faith obligation).

- Conclusion: the principle of loyalty applies to a wide time span of events starting from contract negotiations to implementation. It may fill gaps in the contracts to an extent which perhaps would not happen in other jurisdictions. And where there are several alternatives to interpret a contractual provision, the principle of loyalty informs or completes the interpretation often in accordance with the contract purpose and the parties' reasonable expectations (and disloyal behavior would clearly be considered a breach of the implied principle of loyalty).
- Case law examples show that the general principles like the principle of loyalty play a substantial role in contract interpretation:

    1. Contract negotiations: Finnish Supreme Court award KKO 1993:130 extended the principle of loyalty to an obligation of the contractor, as an expert in construction, to inform the owner of the adverse consequences of a change proposed by the owner in the negotiations, albeit the owner should have known that the proposal would lead to a less than satisfactory result. The construction concerned the port of Hanko. The contractor was thus held liable for the costs caused by the non-intervention during the contract negotiations;

    2. Obligation to notify additional work: In the Swedish Supreme Court NJA 2002 p 630 case it was noted that even though the contract terms did not include a provision for consequences of failed notification of additional work, the conclusion must be that the contractor cannot claim compensation for remedial work already performed as if it was additional work (i.e. it had forfeited its right to compensation). This meant that the Employer had a right to know in advance whether the Contractor denied responsibility for the remedial work and intended to claim the work as additional. A similar Finnish Supreme Court case exists;

    3. The principle of loyalty may override or fill gaps in commercial contracts: Norwegian Supreme Court (*Hoyesterett* HR-2005-397-A) found that a fishing company was in breach of contract when it transferred the production concession from the slaughter house it had agreed with to another slaughter house even in the absence of express contract provision prohibiting the transfer. The transfer was considered to deprive the contract of its significance for the first slaughterhouse. In its reasoning, court in *Hoyesterett* noted that it would have been desirable that the prohibition to transfer the concession had been regulated in the contract, but the absence of express provision did not prevent such a restriction to be "construed".

Netherlands: As mentioned in the general introduction on Dutch contract law, according to article 6:2 DCC, the creditor and debtor to an obligation must behave themselves towards each other in accordance with the standards of reasonableness and fairness. This

principle of reasonableness and fairness is of importance when interpreting a contract via the '*Haviltex* standard'. Given article 6:248 DCC, this principle of reasonableness and fairness, may effectively add an obligation that was not expressly stated in a contract, or it may result in an express contract term not being enforced, insofar as this contract term, given the specific circumstances, would be unacceptable to standards of reasonableness and fairness.

Sweden: The answers given for Finland above include Swedish practice and are thus relevant for Sweden. There is also a specific notion of the duty of loyalty in the general terms AB. According to the preamble of AB, which is an agreed document on construction contract terms, the parties shall consider the principle of loyalty and show each other confidence and openness. The Supreme Court has stated that in construction contracts there is a general principle of loyalty, and each party must as far as possible avoid causing the other party harm inside the frame of the contract.

SPECIAL NOTE ON AUSTRALIA:

Australia is a common law country with significant legislative intervention in construction.

It consists of a national Commonwealth jurisdiction, six States and two main Territories. The framework of Australian legislation is accordingly complex. The States, as former British colonies, historically had plenary legislative power. Under the Australian Constitution, the States granted the Commonwealth power to legislate in defined areas (defence, foreign affairs, corporations, interstate trade and so on). Outside these defined areas, the States retain legislative power and generally are the jurisdiction that regulates construction projects.

The common law of Australia is conceptually simpler: there is said to be a single common law of Australia. (*Farah Constructions Pty Ltd v Say-Dee Pty Ltd* (2007) 230 CLR 89 [135].) The High Court of Australia is the ultimate source of these common law principles. Much of Australia's common law is derived from and consistent with the common law of England and Wales. Nonetheless, as former Chief Justice French observed in 2016: 'The common law in Australia is the common law of Australia. … The common law of England was a source of law for legal development in Australia, but not the only source.' (*Paciocco v Australia and New Zealand Banking Group Ltd* [2016] HCA 28, [9].)

Contractual interpretation is governed by the common law. The High Court has recently expressed its overarching approach to contractual interpretation (*Electricity Generation Corporation v Woodside Energy Limited* (2014) 251 CLR 640, [35]) thus:

'The meaning of the terms of a commercial contract is to be determined by what a reasonable businessperson would have understood those terms to mean … it will require consideration of the language used by the parties, the surrounding circumstances known to them and the commercial purpose or objects to be secured by the contract.'

Australian courts persistently emphasise the objective meaning of contractual text, as part of the contract as a whole. Evidence of surrounding circumstances may also be used in interpretation, but this evidence is typically limited in scope to matters such as the genesis and purpose of the transaction, background facts known to both parties, and the particular market context. In the realm of contractual interpretation, evidence of negotiations is otherwise inadmissible, as is evidence of the parties' subjective beliefs and their actions after the contract was formed.

As this brief summary may suggest, many aspects of Australian contract law echo the common law in other jurisdictions. One important difference, nonetheless, is statutory intervention in the form of the Australian Consumer Law (Schedule 2 to the *Competition and Consumer Act 2010* (Cth).) The Australian Consumer Law includes a wide-ranging prohibition on misleading or deceptive conduct in trade or commerce. Remedies for contravention include damages, injunctions and rescission. Misleading or deceptive conduct claims are routinely brought alongside contractual claims in major construction disputes. Another more recent statutory intervention is a prohibition on unfair contract terms in standard form small business contracts; these terms are void where the regime applies. Since the regime applies only where the claimant has under 20 employees and has entered into a contract with a lump sum price of AUD300,000 or lower (or AUD 1 million for contracts over 12 months), it is most significant for small projects, subcontractors, suppliers and consultants.

In short, construction disputes in Australia are resolved by contractual principles broadly consistent with other common law jurisdictions, but there are some statutory complications.

SPECIAL NOTE ON THE NETHERLANDS:

Like most countries in continental Europe, the legal system in The Netherlands is a civil law system. In this legal system, contract law is generally governed by three main principles, (i) freedom of contract, (ii) absence of prescribed form ('*vormvrijheid*'), and (iii) the binding character of a contract ('*pacta sunt servanda*'). That application of these general principles should help to provide insight into interpreting language like the Sample Clauses discussed in this paper.

Freedom of contract means that parties are at liberty to enter into a contract with whom they want, on what basis and when they want. This freedom of contract, however, may find a boundary if there is a conflict with a provision of mandatory law, or if the juridical act, by its content or necessary implications, violates public morality or public order. (article 3:40 Dutch Civil Code ('*DCC*'), of which an English translation can be found at www.dutchcivillaw.com). Different from Property Law ('*Goederenrecht*'), there is hardly any mandatory law in respect of Contract Law.

Most of our legislation on contract law can be considered as permissive law, allowing parties to deviate in their contracts from statutory provisions. An exception is made for those articles which are specifically mentioned in article 6:250 DCC.

Unless a statutory provision or a juridical act provides otherwise, statements, including notifications and announcements, may be expressed in any form, and they may even reach expression through the behavior of a person, according to article 3:37 DCC. An example of a provision that prescribes in which form an agreement should be made, is article 7:2 DCC, dealing with sales agreements. According to this article, the sale of an immovable thing or a component thereof that is intended to be used as a dwelling, has to be concluded in writing if the buyer is a natural person who, when entering into the agreement, does not act in the course of his professional practice or business.

The third principle is based on the concept that a promise is a promise. In the Dutch Civil Code applicable prior to 1992, article 1374 DCC (old), stipulated that all properly concluded agreements, had to be considered as 'law' for those who are party to the agreement. Although not as clearly worded as in the old DCC, this legal effect of an agreement can still be found in article 6:248 DCC. An agreement has the legal effects which parties agreed upon.

Book 6 of the Dutch Civil Code holds the law of obligations. 'Obligations' can be described as a specific legal relationship between in principle two parties, the creditor and the debtor. Obligations can only come to existence (arise) if this results from law (article 6:1 DCC). Obligations may ensue, for example, from contract, a tortious act ('onrechtmatige daad'), benevolent intervention ('zaakwaarneming'), undue performance ('onverschuldigde betaling') or unjustified enrichment ('ongerechtvaardigde verrijking'). Title 5 of Book 6 of the Dutch Civil Code holds the provisions regarding agreements in general. An 'obligatory agreement' is defined as a more sided (multilateral) juridical act under which one or more parties have subjected themselves to an obligation towards one or more other parties (article 6:213 DCC). According to article 6:217 DCC, an agreement comes to existence by an offer and its acceptance.

Book 7 of the Dutch Civil Code deals with some specific agreements, such as, for example, the sale agreement, the lease agreement and the employment agreement. For the construction practice, title 12 of Book 7 of the DCC is in particular relevant, as this title deals with the statutory provisions regarding construction agreements (articles 7:750-7;769). In general, the statutory provisions provided in Book 7, are considered specific provisions that are applicable besides the general provisions of Book 6.

When it comes to contract interpretation, a main principle throughout the Dutch Civil Code, is the principle of reasonableness and fairness, or 'good faith' in the wording of the old Dutch Civil Code. Looking at the law of obligations as laid down in Book 6 of the Dutch Civil Code, the importance of this principle becomes apparent from article 6:2 DCC. According to this provision, the creditor and debtor must act towards each other in accordance with the standards of

reasonableness and fairness. A rule in force between them by virtue of law, common practice or a juridical act, does not apply as far as this would be unacceptable, in the circumstances by standards of reasonableness and fairness. Thus, this principle governs all obligations between persons, the creditor and the debtor, irrelevant whether the obligation is a result of an agreement (contract) or ensues from a statutory obligation, such as the obligation to reimburse inflicted damages.

This principle of reasonableness and fairness is considered of such importance, that legislation repeated this principle with respect to the statutory provisions regarding the legal effects of agreements. An agreement not only has the legal effects which parties have agreed upon, but also those which, to the nature of the agreement, arise from law, common practice or the standards of reasonableness and fairness. A rule, to be observed by parties as a result of their agreement, is not applicable insofar this, given the circumstances, would be unacceptable to the standards of reasonableness and fairness (article 6:248 DCC).

Reasonableness and fairness are considered of great importance as one cannot expect parties to take into consideration all eventualities. Since the factual situation may change upon concluding an agreement or the relationship between the parties may be influenced, it is possible that the agreement between parties takes on new aspects. The origin of this legal principle dates back to Roman law, which distinguished between '*actiones bonae fidei*' and '*actiones stricti iuris*', and allowed an appeal to the principle of '*exceptio doli (generalis)*' to prevent injustice with respect to agreements. Thus, the principle of reasonableness and fairness refers to unwritten law.

This principle of reasonableness and fairness is applicable beyond the field of property law, as article 3:15 DCC, amongst others, stipulates that article 3:12 is also applicable outside the field of property law as far as the nature of the legal relationship does not oppose to this. At determining what the principle of reasonableness and fairness demands in a specific situation, one has to take into account the general accepted legal principles, the fundamental conceptions of law in The Netherlands and the relevant social and personal interests which are involved in the given situation.

From the previous remarks, it becomes clear that the principle of reasonableness and fairness can fill a gap in the agreement between parties ('*aanvullende werking'*), but it may also set aside or replace a contractual provision that parties have agreed upon if the outcome of adhering to this provision, under the relevant circumstances, would be unacceptable in view of the harmed interests of one of the parties involved ('*beperkende werking*'). The Supreme Court ('*Hoge Raad*'), applied the possibility to replace a contractual term more than 50 years ago in its decision of May 19, 1667 (*ECLI:NL:HR:PHR:1967:AC4745, NJ 1967/261, Saladin/HBU*). This case dealt with the question if a bank, HBU, could exonerate itself towards a client, Saladin, for damages arising from an unlawful act by the bank. The Supreme Court ruled that the answer to this question depended on the evaluation of specific circumstances. This restrictive effect of the principle of reasonableness and fairness has now found a legal basis in article 6:248 sub 2 DCC.

It needs to be noted, however, that caution is required when applying this restrictive effect of said principle. *Pacta sunt servanda* is still the main principle to which parties must adhere. A judge should be reticent when applying this principle, as becomes clear by the use of the words '*unacceptable*' in article 248 sub 2 DCC. This aspect is sometimes overlooked by claimants and judges as well, as is illustrated in decision of the Supreme Court of February 25, 2000 (*ECLI:NL:PHR:2000:AA4942, NJ 2000/471, FNV/Frans Maas*). The Supreme Court decided that the District Court had applied a wrong standard by deciding that an agreement had to be modified because it was '*unfair*' to adhere to the strict text of the agreement. According to the Supreme Court, the District Court had used a different standard than the more restrict standard of '*unacceptable* to standards of reasonableness and fairness'.

Although article 248 DCC provides for ways to reshape the content of an agreement, this may not lead to an unlimited modification of an agreement. For example, applying this rule may not result in general conditions of one of the parties becoming applicable if this was not agreed upon (*Supreme Court, February 6, 2004, NJ 2004/349, Van der Linde/Heutink*).

Sometimes parties discuss their agreements and whether or not there is an omission in the agreement. Under Dutch law, these questions need to be answered in view of the '*Haviltex* criterion' (*Hoge Raad June 14, 2013, ECLI:NL:HR:2013:BZ3749, NJ 2014/415*). This *Haviltex* criterion refers to a decision of the Dutch Supreme Court regarding the standards for interpreting agreements (*Hoge Raad, March 13, 1981, ECLI:NL:PHR:1981:AG4158, NJ 1981, 635, Ermes c.s./Haviltex*). The essence of this decision is that the way a contract governs the relationship between the contracting parties and whether there is an omission in the contract, cannot be explained only by looking at the wording of the contract itself. The intention that parties in all fairness could give to a provision based on their reasonable expectation toward each other is relevant. In other words, relevant is to find out what the *subjective* intention of the parties was. In doing so, one must also look objectively at all circumstances, such as the wording of the contract.

A more objective approach was taken by the Supreme Court in a case regarding the interpretation of a collective labor agreement. In this decision the Supreme Court decided that when it comes to the interpretation of a collective labor agreement, the wording of this agreement is in principle decisive, but other circumstances are still relevant (*Hoge Raad* September 17, 1993*, ECLI:NL:HR:1993:ZC1059, Gerritse/Hydro Agri Sluiskil and Hoge Raad* February 20, 2004*, ECLI:NL:PHR:2004:AO1427, NJ 2005/493, DSM/Fox*). The reasoning behind this decision was that if a party is not involved in negotiating a contract and thus unable to influence the wording of the contract, the intention of the parties when entering into a contract is less relevant. In such case, a more objective interpretation based on the wording of the contract would be more appropriate.

In its decision of April 5, 2013 (*Hoge Raad,* April 5, 2013*, ECLI:NL:HR:2013:BYT8101, NJ 2013/214, Lundiform/Mexx*), the Supreme court decided that although when interpreting a commercial contract concluded between professional parties, the wording of a contract is of

great importance, it does not alter the fact that other relevant circumstances than the exact wording may give a different meaning to contract provisions. Decisive is still the intention that parties in all fairness could give to their contract provisions.

Interesting is that the Supreme Court in the *Lundiform/Mexx* case made a remark about a so-called '*entire agreement clause'*. These clauses are common in Anglo-Saxon contracts but have no specific meaning under Dutch law according to the Supreme Court. According to the Supreme Court, the ratio of an entire agreement clause, is to make clear that parties are not bound by previous agreements related to the contract concluded. This means that when it comes to interpreting a contract, statements and behavior prior to the parties entering into a contract are still relevant, even if the contract provides for an '*entire agreement clause*'.