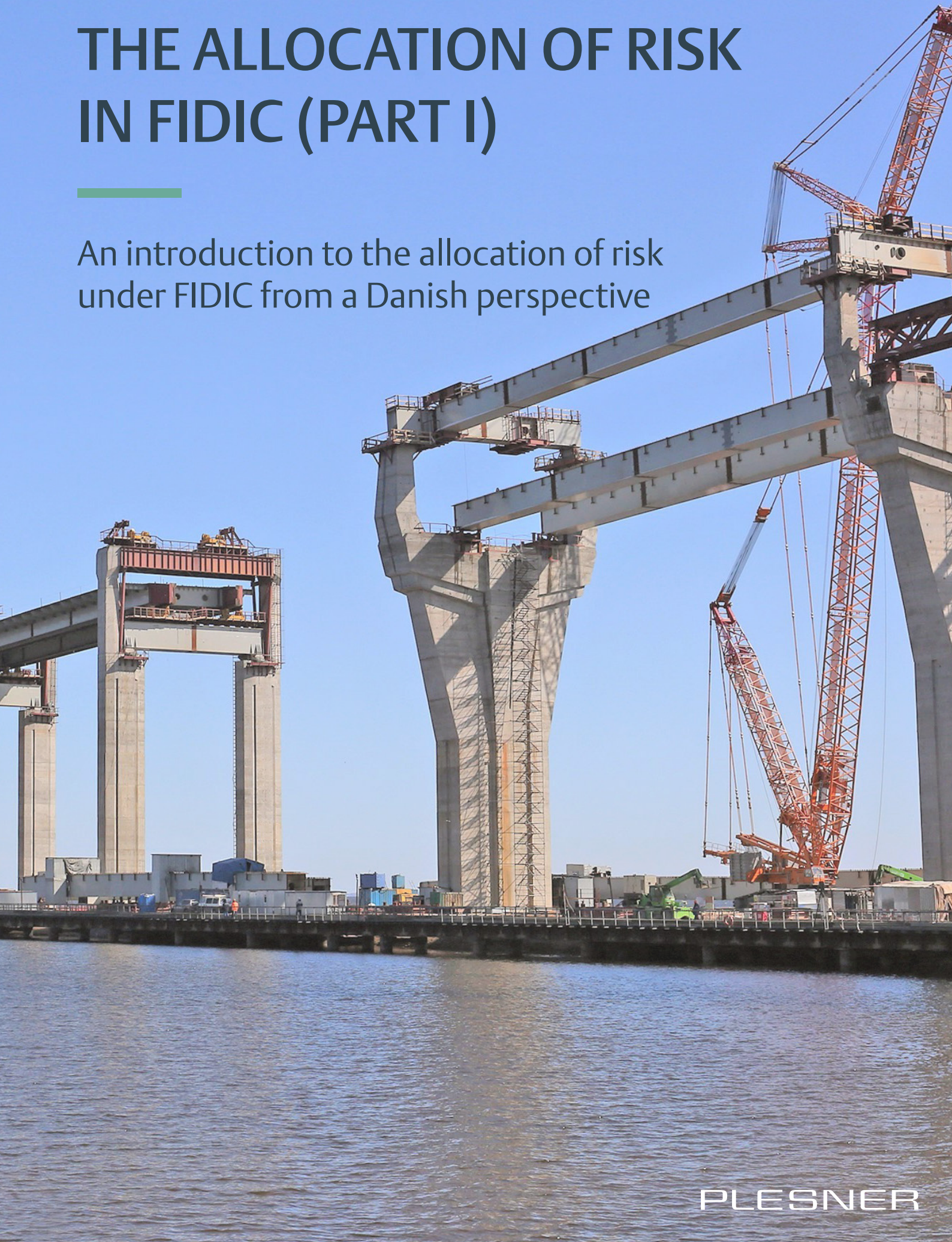


THE ALLOCATION OF RISK IN FIDIC (PART I)

An introduction to the allocation of risk
under FIDIC from a Danish perspective



INTRODUCTION

In any construction project, uncertain events will likely occur, which will have an effect on the achievement of the projects' objectives, such as time, money and quality. Such uncertain events in construction projects commonly include unexpected ground conditions, inadequate plans, delays, weather conditions, inadequate specifications, faulty materials or workmanship, extra work etc. and risks related to such events should always be foreseen, managed and allocated in the construction contract.

When allocating such risks, the following four questions are relevant to ask and assess:

- Which party can best foresee the risk?
- Which party can best control the risk and associated consequences?
- Which party can best bear that risk, e.g. can a party transfer the risk, e.g. through insurance?
- Which party ultimately most suffers or benefits when the risk eventuates?

The responses to these questions are reflected in FIDIC, and in the below short paper, we will assess how the Fédération Internationale Des Ingénieurs-Conseils (FIDIC) have decided to allocate the risk between contractor and employer relating to force majeure, unforeseen ground conditions and change in law¹. Focus will be on the FIDIC Red (Construction Contract), Yellow (Design and Build) and Silver (Turnkey/EPC) books².

FORCE MAJEURE/ EXCEPTIONAL EVENTS

An uncertain event, which may arise during a construction project, and which may have an impact on both time, money and quality, is the force majeure event, which particularly has become relevant following the Covid-19 pandemic. The allocation of risk related to such force majeure event is regulated in Clause 18 of the FIDIC Red, Yellow and Silver Book.

From the first edition of the Red, Yellow and



Silver book in 1999 until the second edition in 2017, the provision was renamed from “Force Majeure” to now “Exceptional Events”. Experience had shown that the practical use of “Force Majeure” was under certain circumstances challenging and unclear, as force majeure is a legal standard with different meanings from jurisdiction to jurisdiction. What constitutes force majeure in the country of the employer, may not constitute force majeure in the country of the contractor.

Consequently, the term “Exceptional Events” was implemented and defined as an event or circumstance which (i) is beyond a party's control, (ii) the party could not reasonably have provided against at contract award and (iii) having arisen, the party could not reasonably have avoided or overcome. This definition corresponds to the definition of force majeure under Danish law. Furthermore, a non-exhaustive list of possible Exceptional Events was implemented in Clause 18 stating events such as war, terrorism, riot, strikes, lockout and natural catastrophes. It is noted that the list does not include epidemics or pandemics.

If a party can prove that an event constitutes an Exceptional Event, as defined above, and the party in fact and consequently is prevented from performing its contractual obligations, the party is excused performance of its obli-

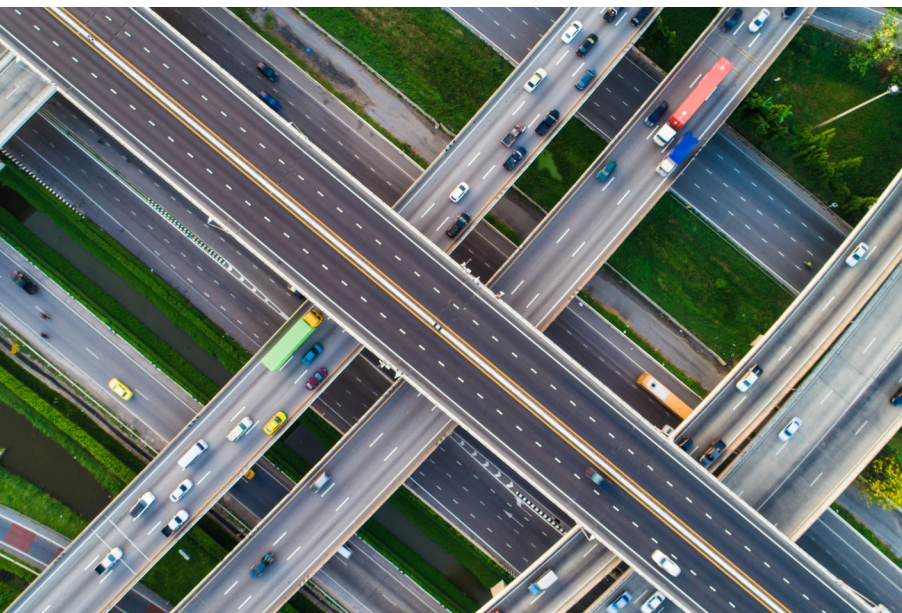
1 It is noted that in Part II of our Insight on the allocation of risk in FIDIC, we will also assess FIDIC's risk allocation connected to performance guarantee, indemnification and insurance.

2 For further information on the application of the FIDIC Red, Yellow and Silver Book, see https://plesner.com/speciale/construction%20law/fidic?sc_lang=en

gations, while prevented from doing so. If the affected party is the contractor, the contractor may be entitled to further relief in the form of an extension of time and/or, in limited circumstances, additional payment.

FIDIC does not deal with the situation, where the affected party is the employer. Most of the risks associated with Exceptional Events are thus allocated to the employer, as a risk he must bear. However, the contractor's share of the hardship associated with Exceptional Events is limited to only being entitled to claim the direct expenditure reasonable incurred in certain specified events as set out in Clause 18.4(b), and thus not any indirect costs, such as loss of profit. You could say that the risk has been partly shared.

Compared to Danish construction law, this can, however, not be seen as a hardship on the contractor, as under the Danish general conditions for building and construction works and supplies, AB18, the contractor would only be entitled to an extension of time in case of force majeure, and thus not any compensation.



CHANGE IN LAW

Under a construction contract, the parties must perform their obligations in compliance with the applicable laws. If such laws change during the term of the construction contract,

the question is, who shall bear the risk of such change.

Under FIDIC³, if the costs of the contractor increase or decrease due to a change in (i) the laws of the country, in which the works are performed, (ii) the interpretation of such laws, or (iii) any permit, permission or license obtained by the employer or contractor, the contract price shall be adjusted. In this respect, “costs” shall be understood as the expenditures reasonably incurred by the contractor in performing the contract.

With respect to the delay risk, the contractor may be entitled to an extension of time, if the contractor can demonstrate that such change in law has caused a delay.

The majority of the risks associated with a change in law are thus allocated to the employer. However, compared to the 1999 edition, the 2017 edition of the Red, Yellow and Silver book has now opened up for the possibility that a change in law not only entitles the contractor to an increase of the contract price, but also the employer to a decrease, if the change in law causes a decrease in the contractor's costs.

Under Danish construction law, a similar risk allocation applies in case of change in law.

UNFORESEEN GROUND CONDITIONS

The risk of unforeseen ground conditions is well known in the construction industry and the effects can often be felt in terms of both time and money. Certain types of work are more likely to be affected by ground conditions, however, as most structures have subsoil foundations of some kind, the principle of unforeseen ground conditions is generally applicable. Accordingly, the risk of potential time and cost consequences should be provided for and considered in every construction contract.

In FIDIC Red and Yellow book, the issue of unforeseen ground conditions is dealt with under the heading “Unforeseeable Physical Conditions”⁴. This term extends to apply to natural physical conditions and physical obstructions (natural or man-made) and pollutants, which

3 Clause 13.6
4 Clause 4.12

the contractor encounters at the site during execution of the work, including sub-surface and hydrological conditions, but excluding climatic conditions and the effects of those climate conditions. The physical conditions must be “Unforeseeable”, which means that it must not be reasonably foreseeable by an experienced contractor by the date 28 days before the latest date for submission of the contractor’s tender⁵.

If the contractor can demonstrate that the physical conditions were “Unforeseeable”, and that the contractor consequently has suffered delay and/or incurred costs, the contractor may be granted an extension of time as well as compensation for costs related to any delay or, if appropriate, costs incurred due to the physical conditions⁶.

The unforeseeability test is decisive for determining the risk allocation for ground conditions and other physical conditions under the FIDIC Red and Yellow book. When applying this test, the following three principles must be considered:

1. The test is not what was actually foreseeable, but what would have reasonably been foreseeable
2. The foreseeability is not that of the specific contractor, but of an experienced contractor
3. The point in time to which the test refers is the date 28 days before the submission of the contractor’s tender, meaning that it must be seen together with the information available to the contractor and the correctness and sufficiency of such information.

In FIDIC Silver book, which concerns EPC/turn-key, the issue of unforeseen ground conditions is also dealt with under the heading “Unforeseen Physical Conditions”. Compared to the Red and Yellow book, the Silver book presents a more thorough ongoing allocation of ground risk. Under Clause 4.12, the Contractor bears the risk of unforeseen ground conditions and

the effect is that no addition to the contract price is payable⁷. The delay risks are not necessarily allocated to the contractor, in case of unforeseen ground conditions, as an extension of time under certain circumstances may be entitled.

Under Danish construction law, similar principles apply, in the sense that if a contractor can demonstrate that ground conditions are unforeseen, and these conditions lead to delay and/or increased costs, the contractor may be granted an extension of time as well as compensation for costs. When assessing the risk allocation under Danish law, emphasis is, however, put on (i) whether the employer has fulfilled his duty to loyally disclose information on ground conditions in the tender documents and (ii) whether the contractor has fulfilled his duty of inspection. If the unforeseen ground conditions are beyond what a contractor reasonably can expect, when reviewing the tender documents, the employer will likely bear the risk of such unforeseen ground conditions, thus leading to an entitled claim for extension of time and costs for the contractor.



5 Clause 1.1.85 in Red book and Clause 1.1.87 in Yellow book

6 Clause 4.12.4

7 Nevertheless, if the unforeseen ground conditions relates to archaeological and geological findings (Clause 4.23), remedial work (Clause 7.6), variations (Clause 13.3.2), changes in laws (Clause 13.6) or exceptional events (Clause 18.3), the contractor may be entitled to payment for compensation for difficulties encountered.

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