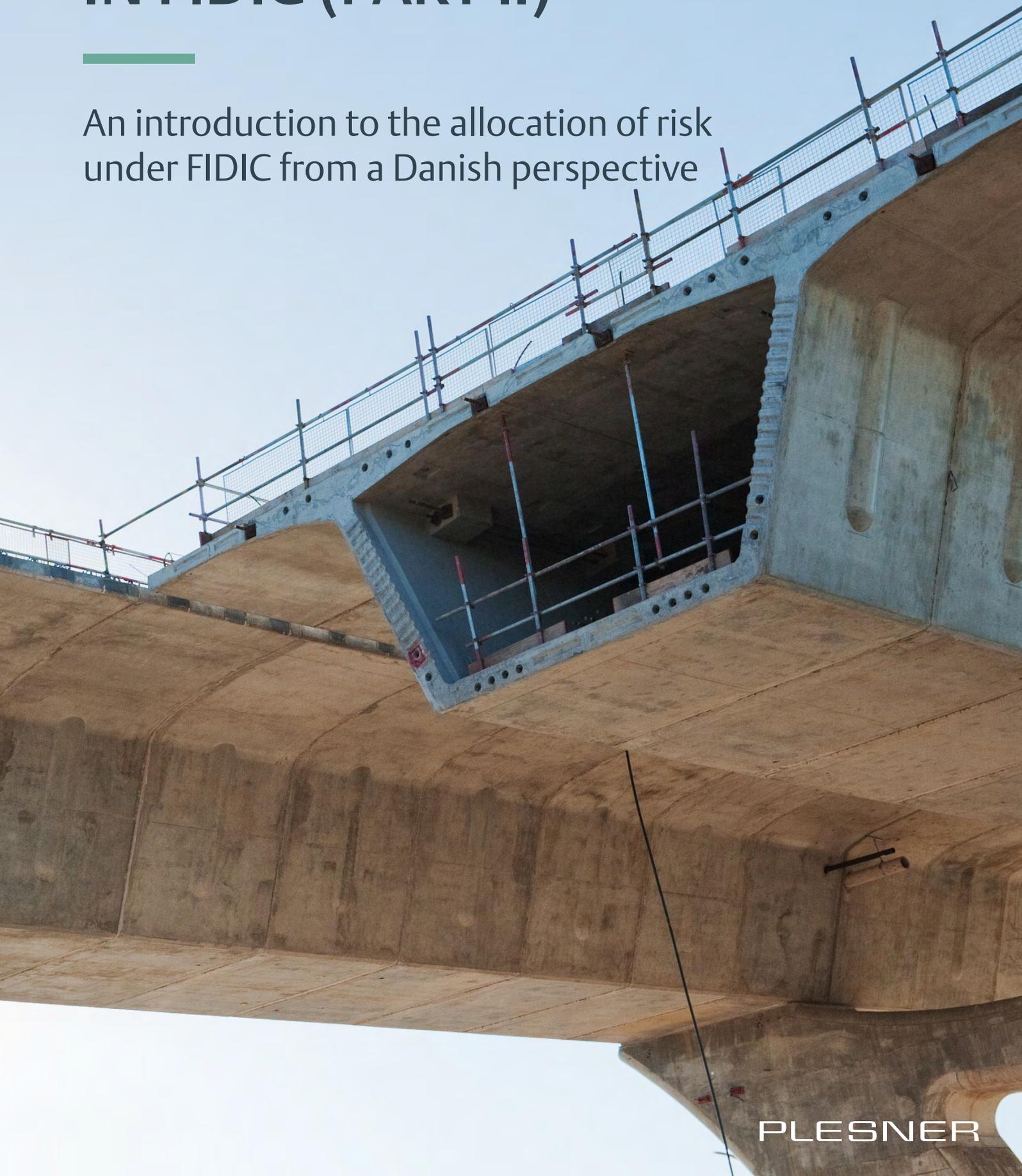


# THE ALLOCATION OF RISK IN FIDIC (PART II)

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



## DELAY

Delays in the construction industry is a major risk often leading to exceeding the initial time schedule and cost budget. Contracts can be a key tool in managing the risks of delay as the financial risks can be distributed between the Employer and the Contractor. The Employer and the Contractor will agree on the time for completion where the Contractor is required to complete the works and very often the contract will provide that the Employer will be entitled to liquidated damages if the Contractor fails to complete the works within the agreed time. However, most contracts will allow for the Contractor to be entitled to time extensions if the delay is caused by certain specified events that cannot be held against the Contractor.

According to FIDIC, a failure by the Contractor to meet the agreed time for completion shall entitle the Employer to “Delay Damages”. These Delay Damages shall be based on a daily penalty (liquidated damages) per each day of delay which is to be further specified in an appendix to the parties’ agreement (“Contract Data”<sup>1</sup>). It should be noted that the Delay Damages are the only damages which the Employer is entitled to claim towards Contractor for its delay, unless to the extent that the specific delay is caused by fraud, gross negligence, deliberately default or reckless misconduct by the Contractor<sup>2</sup>. In such case, the Contractor’s liability for delay shall be unlimited.<sup>3</sup>

Construction contracts usually assume that the Contractor shall not be unconditionally liable for its delays. To the extent that the Contractor is entitled to extension of time, Contractor shall be exempted from liability for delay. According to FIDIC, the Contractor shall be entitled to extension of time when the delays are caused by either (i) variations of the works<sup>4</sup>; (ii) any cause listed in the Sub-Clauses of FIDIC (e.g. delays caused by authorities as set out in Sub-Clause 8.6);<sup>5</sup> (iii) exceptionally adverse and unforeseeable climatic



conditions; (iv) unforeseeable shortages in the availability of personnel or goods caused by epidemic or governmental location of the site; and (v) any delay, impediment or prevention attributable to the Employer, including its personnel and other contractors on site. The risk of these events is reasonably placed on the Employer which is fully in line with how a contractor’s or a supplier’s delay generally would be assessed according to standard contract law and Danish law in general.

Further to the above, the Contractor’s entitlement to extension of time is generally subject to the Contractor’s compliance with the formal requirements of notice (claims for payment and/or EOT).<sup>6</sup>

It is noted that the Contractor’s entitlement to an extension of time in case of a delay does not, in itself, entitle the Contractor to any compensation for cost being a result of that given delay. Thus, the above list of circumstances giving right to extension of time is solely a matter of exempting the Contractor for liability (Delay Damages). The Contractor’s right to compensation for delay costs provides that the delay is caused by certain events for which the Employer bears the risk, including errors in the Client’s (technical) requirements;<sup>7</sup> compliance with laws;<sup>8</sup> access to the

1 Sub-Clause 8.8, section 1.

2 Sub-Clause 8.8, section 2.

3 Sub-Clause 8.5, section 3.

4 Note, in terms of the Employer increasing the measured quantity of any item of work it is provided that the increase must be greater than 10% and that it does in fact cause a delay to the completion date.

5 This would include the circumstances or events prescribed in Sub-Clauses 1.9, 1.13, 2.1, 4.6, 4.7, 4.12, 4.15, 4.23, 7.4, 7.6, 8.5, 8.6, 8.10, 8.12, 10.3, 11.7, 13.3, 13.6, 16.1, 16.2, 17.2 and 18.4.

6 Sub-Clause 20.2.

7 Sub-Clause 1.9.

8 Sub-Clause 1.13.

site;<sup>9</sup> lack of cooperation;<sup>10</sup> unforeseeable physical conditions;<sup>11</sup> interference or delays with tests on completion.<sup>12</sup>

Further, note that FIDIC does not clearly prescribe whether the above list of circumstances entitling the Contractor to extension of time is an exhaustive list or whether Contractor would also be entitled to claim an extension of time under generally applicable principles of applicable law. Therefore, this could advantageously be considered by the parties in the special conditions under the FIDIC contract.

Finally, it is noted that according to FIDIC when a delay is (equally) caused by both circumstances attributable to the Contractor respectively to the Employer (concurrent delays), the Contractor's entitlement to extension of time shall be assessed in accordance with the rules and procedures set out in the parties' special provisions (if any). If the parties have not adopted any special conditions, the Contractor's entitlement to extension of time shall be based on an appropriate assessment of all relevant circumstances (meaning applicable laws). Under Danish applicable law, when nothing specifically has been agreed between the parties, the courts tend to grant the Contractor the right to extension of time however without any right to compensation or a smaller compensation reflecting the parties' proportionate liability.



## PERFORMANCE

When the Contractor is constructing a process plant or other facility that will produce a product, the Employer will most often demand the Contractor to demonstrate that such plant fulfills the requirements set out in the contract. In such cases the parties will agree on certain performance related requirements which typically comprise of a set of criteria in the contract which stipulates how the plant should perform or the standards that it must achieve in a specific set of circumstances. The Contractor will have to perform tests and comply with agreed performance requirements before commissioning and before the plant is handed over to the Employer. In some cases, the plant must also meet the performance requirements subsequent to the risk being taken over by the Employer.

In the event that the works fail to meet the agreed performance requirements, the Contractor will most often have the opportunity to rectify any deficiencies in order to demonstrate that performance requirements have been met. However, if the Contractor fails to meet the agreed performance requirements after attempting to rectify, the contract may also provide for liquidated damages from the Contractor to the Employer for the purpose of compensating the Employer for any limited shortfall in performance. Moreover, some contracts will specify certain minimum performance levels or limitations on attempts to rectify which allow the Employer to reject the plant if the Contractor fails to meet such requirements.

FIDIC provides for two sets of tests in relation to the performance of the works: (i) tests on completion and (ii) tests after completion.<sup>13</sup> Tests on completion comprise of pre-commissioning tests, commissioning tests and trial operation. If the parties have agreed on performance requirements, such completion tests shall be performed after trial operation to demonstrate whether the works comply with the agreed requirements.<sup>14</sup>

If the works or part thereof fail to pass tests on completion, the Employer shall be entitled to require repetition of tests pursuant to Sub-Clause

9 Sub-Clause 2.1.  
10 Sub-Clause 4.6.  
11 Sub-Clause 4.12.  
12 Sub-Clause 10.3 and 12.2.  
13 Sub-Clause 9.  
14 Sub-Clause 9.1.

9.3.<sup>15</sup> The Employer may also decide to (i) reject the works if failure to reach tests on completion deprives the Employer of substantially the whole benefit of the Works<sup>16</sup> or (ii) issue a taking-over certificate<sup>17</sup>. If the Employer decides to issue a taking-over certificate, the Employer shall be entitled to reduce the contract price in full satisfaction of this failure. Such amount shall be appropriate taking into consideration the reduced value of the works as a result of the failure.<sup>18</sup>

In addition, FIDIC provides for tests after completion. Tests after Completion are the tests in the Special Provisions<sup>19</sup> if agreed by the parties in the construction contract<sup>20</sup>. However, contrary to the definition of Tests on Competition<sup>21</sup>, this definition does not include provisions for implementing changes to the test regime through agreement or instruction. If the Works fail to pass the Tests after Completion, the procedure in Sub-Clause 11.1 (i)-(iii) shall apply.



## INDEMNIFICATIONS

A fundamental way to manage risk allocation in construction is by adding an indemnity clause to the contract. By indemnities the parties can allocate the risk of loss or damages as a result of certain events. The indemnifier will assume the risk covered by the indemnity clause and shall undertake to hold the indemnified party harmless against the consequences of that event.

<sup>15</sup> Sub-Clause 9.4(a).

<sup>16</sup> Sub-Clause 9.4(b).

<sup>17</sup> Sub-Clause 9.4(d).

<sup>18</sup> Sub-Clause 9.4 and 11.4(b).

<sup>19</sup> The key document, together with the Drawings, which specifies the scope of the Contractor's work as defined in Sub-Clause 1.1.76.

<sup>20</sup> Sub-Clause 1.1.82.

<sup>21</sup> Sub-Clause 1.1.83.

Under FIDIC, Clause 17 sets out an extensive indemnity scheme where various types of risks are addressed. For historic reasons Clause 17 covers both Care of the Works and indemnities as Clause 17 is formulated this way in the 1999 edition. The passing of risk (Care of the Works) is addressed in Sub-Clause 17.1 [*Responsibility for Care of the Works*]; some exceptions to the allocation of risk are stated in Sub-Clause 17.2 [*Liability for Care of the Works*]. Indemnities are dealt with in the remaining Sub-Clauses: Sub-Clause 17.3 [*Intellectual and Industrial Property Rights*]; Sub-Clause 17.4 [*Indemnities by Contractor*]; Sub-Clause 17.5 [*Indemnities by Employer*] and Sub-Clause 17.6 [*Shared Indemnities*].

### Indemnities by Contractor

Sub-Clauses 17.4 and 17.5 set out specific indemnities. In essence the two Sub-Clauses are drafted in the same manner, disregarding the last paragraph of Sub-Clause 17.4. Each party shall indemnify the other Party against claims, damages, losses etc. in respect of bodily injury, sickness, disease, or death of any person. However, the Contractor shall indemnify the Employer from any claims etc. if the claim arises out of the Contractor's execution of the Works, regardless of any negligence or breach of the Contract by the Contractor. The Contractor shall not indemnify the Employer if the claim arises out of the Employer's negligence (or the Employers Personnel's or their respective agents'), willful act or breach of the Contract.

With regards to property damage (i.e. physical damage), the Contractor shall indemnify the Employer against claims arising out of the Contractor's execution of the Works. However, only to the extent the claim is attributable to any negligence, willful act or breach of the Contract by the Contractor, the Contractor's Personnel or their respective agents or anyone directly or indirectly employed by either, i.e. sub-contractors etc.

Pursuant to the last paragraph of Sub-Clause 17.4, the Contractor shall indemnify the Employer to the extent that the Contractor is responsible for the design of part of the Permanent

Works<sup>22</sup> or any other design under the Contract. In such case the Contractor shall indemnify the Employer against the Contractor's acts, errors, and omissions in designing such parts that result in the Works not being fit for purpose(s) for which they are intended. If the Contractor is to undertake some design responsibility, the Contractor may wish to specify the exact extent of liability in the Special Provisions.

Sub-Clause 17.4 does not provide an explicit obligation to indemnify the Employer against third party claims that may not be based on damage to or loss of property. Depending on the project, such explicit obligation should be considered in amending the Special Provisions.

The Contractor's liability under the first paragraph of Sub-Clause 17.4 is not subject to the limitations in Sub-Clause 1.15 as this liability is expressly exempted from the limitations.<sup>23</sup> However, the Contractor's liability under the second paragraph of Sub-Clause 17.4 is limited by Sub-Clause 1.15 both in respect of indirect or consequential loss or damage and the global limitation (cap).

### Indemnities by Employer

In addition to Sub-Clause 17.5 (a), which reflects Sub-Clause 17.4, the Employer shall indemnify the Contractor against damage to or loss of property caused by any of the events described in sub-paragraphs (a)-(f) of Sub-Clause 17.2.

Pursuant to the last part of sub-paragraph (f) relating to acts or defaults by the Employer's other contractors, the Employer is responsible for the Employer's other contractors in the following cases: interference delaying the completion of the Works (sub-paragraph (e) of Sub-Clause 8.5 [*Extension of time for Completion*]); damage to Works (sub-paragraph (f) of Sub-Clause 17.2); or damage to the Contractor's property, other than the Works (sub-paragraph (b) of Sub-Clause 17.5 [*Indemnities by Employer*]). If the stated Sub-Clauses are left unamended, it may result in a less desirable liability scheme for the Employer and requires the Employer to co-ordinate the liability profiles between all contractors to ensure that any liability for the Employer under one contract is covered by a similar right to indemnification under the other contacts.

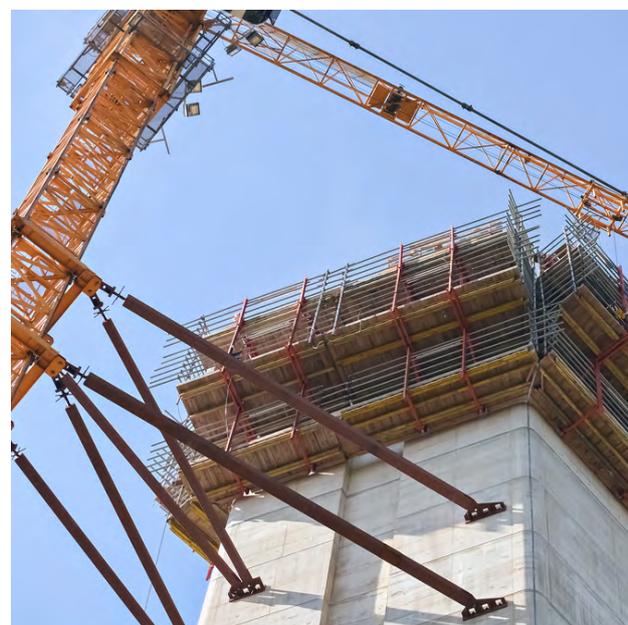
<sup>22</sup> Sub-Clause 4.1.

<sup>23</sup> Sub-Clause 1.15, sub-paragraphs (f) and (iv).

### Shared indemnities

Under Sub-Clause 17.6, the obligation to indemnify the other Party may be reduced proportionally if the other Party - or an event for which the other Party is responsible - contributed to the damage, loss, or injury. That is, if the situation at hand is a combination of a liability under Sub-Clause 17.4 and a liability under Sub-Clause 17.5, the mutual obligations to indemnify are reduced proportionally.

It is noted that neither Sub-Clause 17.4, 17.5 or 17.6 provides a procedure for managing third-party claims, similar to the last paragraph of Sub-Clause 17.3. For the sake of good order, it may be prudent to add such procedure for all these three Sub-Clauses in the Special Provisions.



### INSURANCE

Insurance is a mechanism by which one party agrees to indemnify another against a predefined category of risks pursuant to a contract of insurance in exchange for a premium. Under FIDIC, the Contractor is required to take out insurance as stipulated in Clause 19. The requirements of Clause 19 are minimum requirements and the Contractor may take out additional insurances to the extent the Contractor deems necessary. The Employer shall give its consent to the insurers and the terms for insurances proposed by the Contractor.

Specifically, the Contractor shall insure against:

- loss or damage to the Works, including contractor's documents, materials and plant for incorporation in the works for "their full replacement value".<sup>24</sup> This insurance shall include "loss and damage of any part of the works as a consequence of failure of elements" if the elements are defectively designed or constructed. Further, the insurance shall cover all damages and losses until the issuance of the taking-over certificate.<sup>25</sup>
- in the joint names of the Contractor and the Employer, loss or damage to goods in compliance with the provisions of the contract data. If the contract data is silent in this regard the Contractor shall insure "for the full replacement value including delivery to site".<sup>26</sup>
- injury to any person, loss of or damage to property and liabilities for death. This insurance must apply to the Contractor and the Employer as separate insureds.<sup>27</sup> In addition, the Contractor is obligated to insure any person employed by the Contractor or any of its personnel".<sup>28</sup>
- professional indemnity insurance if the Contractor is responsible for the design of part of the permanent works under Sub-Clause 4.1.
- all "other insurances" that may be required by law.<sup>29</sup>

If the Contractor fails to take out and keep in force any of the above-mentioned insurances, the Employer may effect and keep in force such insurances and the Employer shall then be entitled to recover any premium that may be paid for the insurances from any amount due to Contractor.<sup>30</sup>



24 Sub-Clause 19.2.1.  
25 Sub-Clause 19.2.1.  
26 Sub-Clause 19.2.2.  
27 Sub-Clause 19.2.4.  
28 Sub-Clause 19.2.5.  
29 Sub-Clause 19.2.6.  
30 Sub-Clause 19.1.

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