

## **FIDIC Golden Principles: a new approach to discouraging inappropriate amendments to standard form contracts**

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### **Introduction**

FIDIC publishes general conditions of contract that are widely used for international construction contracts. They are intended to be used in any legal jurisdiction.

The FIDIC General Conditions (GCs)<sup>1</sup> are explicitly based on a fair and equitable risk allocation between the Employer and Contractor, and are widely recognised as striking an appropriate balance between the reasonable expectations of the contracting Parties.<sup>2</sup>

Arguably, a contract recognised as a fair and balanced 'FIDIC Contract' has real commercial value to both the Employer and Contractor, both at the tendering stage and while the works are being performed.

GCs prepared for use in a wide range of projects and jurisdictions inevitably require supplementation with Particular Conditions (PCs) that address the particular requirements of the Site and unique features of the specific project. PCs may also be necessary to amend the GCs to comply with mandatory law that applies to the Site or legal jurisdiction.

Provided that such modifications are limited to those necessary for the particular features of the Site and project, and do not change the essential fair and balanced character of a FIDIC Contract, the contract is recognisable as a FIDIC Contract.

The essential features of a FIDIC Contract that make the risk/reward allocation fair and balanced are referred to as the FIDIC Golden Principles (GPs).

This article outlines the development of the GPs and the reasons for them, and their application in drafting PCs.

### **Fair and balanced contracts**

Contract risks refer to the chance that contractual objectives will not be fulfilled. The contract defines who bears the liability for the contract risks. The form and terms of the contract can increase or decrease those risks from the norm. Thus, the use of the appropriate form and terms of a construction contract can play a major role in minimising the risk that the contractual objectives will not be fulfilled. Conversely, the use of an inappropriate form or terms of a construction contract can significantly increase the risk that the contractual objectives will not be fulfilled.

Strictly, it is incorrect to refer to contracts as 'allocating' risk because contracts allocate obligations and confer rights.<sup>3</sup> A risk, being the chance of an event happening, is not 'allocated' to either Party by the contract. A risk event may exist separate and independent of the obligations and rights of the Parties, or the risk event may be under the 'control' of one of the Parties. Whether or not one of the Parties has 'control' over a risk event, it is the obligations and rights arising as a consequence of the risk event happening that are 'allocated' by the contract, and this is the commonly accepted usage of the term 'risk allocation'.

Many standard form contracts are based on the explicitly stated principle of balanced or fair risk allocation, for example, the Australian Standard 4000 series;<sup>4</sup> United States ConsensusDocs;<sup>5</sup> United Kingdom New Engineering Contract;<sup>6</sup> and contracts promoted by the European Engineering Industries Association,<sup>7</sup> International Chamber of Commerce,<sup>8</sup> Baltic and International Marine Council,<sup>9</sup> and UK offshore oil and gas industry.<sup>10</sup> The principle is also espoused by government procurement agencies in the UK,<sup>11</sup> Australia<sup>12</sup> and the US.<sup>13</sup>

Many writers suggest that adherence to the principle of balanced risk allocation enhances the prospect of successful contracts

by encouraging contractual performance that minimises adverse outcomes and thereby reduces disputation.<sup>14</sup> In a survey of ten case studies of Australian projects to determine project-related factors critical to project success, Sidwell, Kennedy and Chan found that equitable risk allocation was one of the top four factors found to be critical in explaining overall project performance, and the most significant factor related to the conditions of contract.<sup>15</sup>

'Nonstandard' contract terms (in the sense of altering the 'normal' balanced risk allocation in standard form contracts) in either standard form contracts or bespoke contracts are usually put forward by one Party to alter the risk allocation to be more favourable to it. As Employers generally put forward proposed conditions of contract with the tender documents, it is likely that nonstandard terms in these contracts will involve the Contractor accepting more risk than 'normal'.

The conditions of contract based on a standard form contract typically comprise GCs and PCs (or amendments to the GCs). The GCs are typically drafted by a committee representing a wide range of interests, and represent a consensus of contract terms appropriate to many 'typical' projects and locations. However, these GCs cannot take account of the specific requirements of a particular project, or perhaps the requirements for a particular location. GCs typically require modification for the project.

Every project has unique circumstances, and there are many legitimate reasons for PCs that alter standard form GCs to suit these circumstances. For example, provisions in the GCs may be inconsistent with the mandatory law of the Site.

Typically, there is no formal constraint on the extent of risk transfer to the Contractor via the PCs, other than the requirements of mandatory law. However, arguably,

PCs that alter the fundamental balanced risk allocation in the GCs change the character of the contract so that it is no longer recognisable as a contract of the type understood by the name of the GCs.

The consequences of inappropriately allocating excessive risk to the Contractor can actually have the opposite effect to that desired by increasing the Employer's risks. The Japan International Cooperation Agency (JICA) commissioned the Association of Japanese Consulting Engineers to prepare a 'Check List for One Sided Contracts' to be used for the preparation of reasonable bidding documents. JICA noted that if modifications for a particular project alter the originally contemplated risk distribution in a FIDIC Red Book contract to a large extent and the risks allocated to the Contractor become excessively high, the following problems may occur:

- higher bid price;
- bid failure and disruption of project implementation;
- non-participation in the bid of conscientious and capable contractors;
- contract award to a bidder who failed in or was not capable of estimating the risks properly;
- poor construction quality and delay to the progress of the work due to lack of risk contingency;
- undermining the relationship of mutual trust and respect between the Employer and Contractor;
- repetition of groundless claims from the Contractor;
- frequent disputes between the Employer and Contractor; and
- in an extreme case, termination of the contract.<sup>16</sup>

### FIDIC GPs

The GPs were developed by Task Group 15 (TG15),<sup>17</sup> which reported to the Contracts Committee. Consistent with FIDIC's structured approach to developing consensus documents, drafts of TG15's report were reviewed

by the Contracts Committee and a number of friendly reviewers. The Second Editions of the FIDIC Red, Yellow and Silver Books recommend that the drafters of PCs take all due regard to the GPs.<sup>18</sup>

The GPs have been articulated for Works Contracts and not Services Contracts. FIDIC has confined its attention to PCs that change the GCs to the extent that they do not comply with the GPs. It has not considered misuse of unamended GCs.

In order to promote understanding, the GPs have been formulated at a conceptual level to encapsulate the essence of a FIDIC Contract. Each GP expresses a single readily understood and generally accepted concept. The GPs have been limited to the minimum number necessary for completeness. Except for GP5, the GPs are stated in broad terms, without reference to specific clauses of the GCs.

GPs function as constraints on modifications to the GCs made in the PCs. They cannot prevent misapplication of existing unamended GCs. By definition, unamended GCs are an application of the GPs.

The following overarching considerations underpin the GPs:

- The terms of the contract are comprehensive and fair to both contracting Parties.
- The legitimate interests of both contracting Parties are appropriately considered and balanced. The legitimate interests of each Party include the right to enjoy the benefits of the contractual relationship generally recognised as implicit in the GCs. For example, the Employer's legitimate interests include the right to a facility constructed to the contractually-specified quality, within the time and for the price under the contract. The Contractor's legitimate interests include the right to execute the Works in the manner contracted for, within a reasonable time and for a commercial price paid on time.

- Best practice principles of fair and balanced risk/reward allocation between the Employer and Contractor are put into effect in accordance with the provisions of the GCs.
- No Party shall take undue advantage of its bargaining power.
- Payments to the Contractor or Subcontractor in accordance with the Contract are adequate to maintain its cashflow.
- The Employer obtains the best value for money.
- To the extent possible, cooperation and trust between the contracting Parties is promoted, and adversarial attitudes are to be discouraged and should be avoided.
- The contract provisions can be practically put into effect.
- Disputes are avoided to the extent achievable, minimised when they do arise, and resolved efficiently.

The GPs are as follows:

- GP1: The duties, rights, obligations, roles and responsibilities of all the Contract Participants must be generally as implied in the GCs, and appropriate to the requirements of the project.
- GP2: The PCs must be drafted clearly and unambiguously.
- GP3: The PCs must not change the balance of risk/reward allocation provided for in the GCs.
- GP4: All time periods specified in the Contract for Contract Participants to perform their obligations must be of reasonable duration.
- GP5: All formal disputes must be referred to a Dispute Adjudication Board (DAB) or Dispute Avoidance/Adjudication Board (DAAB) for a provisionally binding decision as a condition precedent to arbitration.

### Reasons for GPs

*GP1: The duties, rights, obligations, roles and responsibilities of all the Contract Participants must be generally as implied in the*

*GCs, and appropriate to the requirements of the project.*

As with most construction contracts, FIDIC Contracts refer to a number of other persons (eg, the Engineer, DAB and Subcontractors), in addition to the contracting Parties (Employer and Contractor). All the persons referred to in a FIDIC Contract (Contract Participants) have clearly defined roles, duties and obligations important to the efficient administration and proper functioning of the contract. Concomitant with those roles are rights defined in the contract.

The allocation of specific roles, duties and obligations to the various Contract Participants in FIDIC Contracts has evolved over a long period, and has stood the test of time. Experience has shown that this allocation is consistent with widely accepted and understood international usage. Further, it is submitted that it provides the best opportunity for the Contract Participants to deliver a project that satisfies the Parties' reasonable performance expectations.

The delivery of a large construction project involves a complex interaction between all the Contract Participants. Each has its own roles, duties and obligations, which interface with the roles, duties and obligations of the other Contract Participants. The roles, duties and obligations defined in a FIDIC Contract have been determined to be those most appropriate to the efficient delivery of the contractual objectives, and best suited to the skills and expertise normally expected of and exercised by the Contract Participants.

A FIDIC Contract is based on the Employer and Contractor undertaking their roles, duties and obligations, and having their rights, under the GCs. For the Employer this involves, for example, providing access to the Site at the time contracted for, and paying the Contractor. For the Contractor it involves, for example, executing and completing the Works in accordance with the Contract, and

rectifying defects during the Defects Notification Period.

The roles, duties and obligations of other Contract Participants as defined in the GCs are equally important for efficiently delivering the contractual objectives (notwithstanding that, not being Parties, they are not bound by the terms of the contract). Thus, for the Red, Pink and Yellow Books, this requires that an Engineer be appointed with appropriate authority, competence and resources to carry out the role, and that they fulfil their duties and obligations as defined in the Contract. Further, the Engineer must exercise its contractual authority and make fair determinations in accordance with the Contract, taking due regard of all relevant circumstances. This means that they must not make determinations that only suit the Employer's interests, without having due regard to the Contractor's rights under the contract.

Similarly, for the Silver Book, the Employer's Representative must have appropriate authority to carry out the role, and must carry out that role to enable the Contractor to enjoy its contractual rights.

*GP2: The PCs must be drafted clearly and unambiguously.*

FIDIC GCs undergo a comprehensive drafting and independent review process to ensure that they are clear and unambiguous. Clear and unambiguous drafting is fundamental to all Contract Participants understanding their roles and duties so they can fulfil their obligations and exercise their rights.

The conditions of a FIDIC Contract comprise the GCs and PCs, which incorporate any additions or changes to the GCs. A 'FIDIC Contract' will only be clearly and unambiguously drafted if the PCs are clearly and unambiguously drafted, and interface harmoniously with the GCs and the Appendix to Tender/Contract Data.

*GP3: The PCs must not change the balance of risk/reward allocation provided for in the GCs.*

Fair and balanced risk allocation is widely accepted as the most appropriate basis for drafting of construction contracts to minimise the prospects of disputes and enhance the likelihood of achieving successful project outcomes. It is a fundamental principle on which FIDIC Contracts are based.

The Abrahamson Principles, well known to construction lawyers, are regarded as the basis of 'balanced' or 'fair' risk allocation.<sup>19</sup> These principles, as refined by Dr Nael Bunni, stipulate that risks should be allocated by considering:

- which Party can best control the risk and the associated consequences;
- which Party can best foresee the risk;
- which Party can best bear the risk; and
- which Party ultimately most benefits or suffers when the risk eventuates.<sup>20</sup>

*GP4: All time periods specified in the Contract for Contract Participants to perform their obligations must be of reasonable duration.*

Time periods specified in the GCs have evolved as a consensus among the international construction community as an appropriate balance between the interests of a Contract Participant required to perform a duty, and the interests of the Party whose rights are dependent on the execution of that duty. FIDIC considers they are reasonable time periods, sufficient to carry out the required duties, but without undue delay.

The consequences of reducing the time periods provided for in the GCs may result in a Contract Participant having insufficient time to properly perform its required duties or exercise its rights. An earlier trigger

of a time bar than is contemplated in the GCs is one potential consequence of reducing time periods.

Conversely, significantly extending those time periods may adversely affect the rights and entitlements of the Party for whose benefit the duties are being performed. For example, a longer period for issuing a payment certificate will result in the Contractor's cashflow being adversely affected.

In many provisions of the GCs, the Parties are invited to amend the 'default' time periods by agreement using words such as 'unless otherwise agreed'. Such time periods are recognised as being determined by negotiation if appropriate, while providing a default option considered to be a reasonable time period.

**GP5:** *All formal disputes must be referred to a DAB or DAAB for a provisionally binding decision as a condition precedent to arbitration.*

The Dispute Avoidance/Adjudication Board (DAAB) in the 2017 Red, Yellow and Silver Books, the DAB in the 1999 Red Book, and the Dispute Board (DB) in the 2010 Pink Book, have evolved as important entities to help the Parties avoid disputes, and as a procedure for resolving disputes (at least provisionally) at much lower cost and in much less time than required for arbitration. The DAAB procedure provides an independent third party that assists in maintaining appropriate communication between the contracting Parties, and promotes early resolution of disputes to enable the project to proceed without unnecessary disruption. The 1999 Yellow Book and 1999 Silver Book provide for an 'ad hoc' DAB, implemented when a dispute has arisen. A DAAB or DAB resolves the conflicts of interest that formerly occurred, where the Engineer (engaged and paid by the Employer) not only certified the Contractor's entitlements under the Contract, but also had the authority to resolve disputes.

If one of the Parties is not satisfied with a DAAB/DAB decision, it can issue a Notice of Dissatisfaction and trigger the arbitration process. However, arbitration can be delayed until the project is complete, helping to prevent project personnel from becoming distracted. In the meantime, the Parties have a decision that provides a provisional resolution of the dispute.

FIDIC considers the availability of an independent and impartial DAAB/DAB to (provisionally) resolve disputes fundamental to a fair and balanced contract, providing this is in conformity with local law. A DAAB/DAB can resolve disputes in real time, and thereby enable the Parties to plan their future activities based on the reasoned decision of experienced, independent and impartial persons who are familiar with the execution of projects and administration of construction contracts.

### **Guidance for drafting contract documents for consistency with the GPs**

Minor additions or grammatical changes to the wording of a GC sub-clause that do not alter the intent are not a breach of the GPs. However, such cosmetic changes should only be made for good reason.

In the PCs, changes to the GCs required to comply with local law are consistent with GC Sub-Clause 1.13, and are necessary and appropriate for the contract to properly express the Parties' legal and contractual obligations. Such changes do not constitute a breach of the GPs.

One of the following terms in a GC generally indicates that it may be amended by the PCs without being in conflict with the GPs:

- 'or as otherwise agreed';
- 'except as otherwise agreed';
- 'unless otherwise agreed';
- 'unless otherwise agreed by both Parties';
- 'unless otherwise stated in the Particular Conditions';
- 'except as otherwise stated in these Conditions'; or

- 'unless otherwise stated in the Contract'; however, this is ambiguous because it does not necessarily refer to the PCs.

It is important that the technical documents do not redefine the duties, rights, obligations, roles or responsibilities of any Contract Participants in a manner that is inconsistent with the GCs as modified by the PCs. For example, the Engineer has a clearly defined role in the Red and Yellow Books to make determinations as required by the contract, after consulting both Parties. It would be a breach of GP1 for a contract to require the Engineer to seek approval from the Employer before issuing any determination under Sub-Clause 3.5 (1999 Editions) or Sub-Clause 3.7 (2017 Editions).

The requirements of the project include the Laws applicable to the execution of the Works, as well as the applicable Laws relevant to the rights and obligations of the Contract Participants. Changes in the PCs to make the contract compliant with the relevant legal regimes are appropriate and necessary, and not in conflict with GP1.

Compliance with GP2 requires, among other things, that each of the documents comprising a Contract provide a cohesive and comprehensive whole, without overlap or inconsistencies. The contents of each contract document should be confined to its scope as generally understood. The appropriate document to amend the GCs is the PCs; the 'contractual' issues detailed in the GCs should not be amended in other documents such as the Employer's Requirements or the Specification.

The content of 'technical' documents, such as the Employer's Requirements, drawings or Specifications, should be confined to technical issues, consistent with the provisions of the GCs as modified by the PCs.

GP3 is a fundamental principle that should be considered in any PC amendment to the GCs. The yardstick to apply in drafting any provision that

amends the roles, duties or obligations as defined in the GCs is to enquire whether risks are being allocated to the Party that is in the best position to control them and bear the consequences of a potential risk becoming a reality. If so, the amendment is compliant with GP3.

There are two alternative considerations involved in complying with GP4 in respect of providing the Contract Participants with a reasonable time to perform their obligations and exercise their rights:

- ‘Fixed’ timeframes (ie, those that are not qualified by a phrase such as ‘unless the parties agree otherwise’) should not be significantly changed from their value in the GCs.
- ‘Default’ timeframes (ie, those that are qualified by a phrase such as ‘unless the parties agree otherwise’) when amended should not provide unreasonably short or unreasonably long timeframes. A timeframe would be unreasonably short if it did not provide sufficient time for the Contract Participant to perform its duties properly or exercise its rights; a timeframe would be unreasonably long if it significantly affects a Party’s enjoyment of its rights, such as the Contractor’s right to suspend or terminate the Works.

GP5 requires that the contract provide for a DAAB or DAB to give a provisionally binding decision on any formal dispute, as a condition precedent to referring a dispute to arbitration.

Compliance with GP5 (and GP1) entails retention of the GC clauses referring to the role and operation of the DAAB/DAB, and not significantly changing its role, duties, obligations and rights as defined in the GCs. This is, however, subject to the caveat that a DAB/DAAB is not incompatible with local mandatory law.

## Conclusion

FIDIC’s initiative in promoting the recognition and application of the GPs is intended to encourage the use of FIDIC GCs as they have always been intended: fair and balanced risk/reward allocation, clear definition of scope, duties, roles, rights and responsibilities, and contract documents that constitute a contract management manual for best practice international project execution.

The use of the GPs is endorsed in the 2017 Editions of the Red, Yellow and Silver Books in the following terms: ‘FIDIC strongly recommends that the Employer, the Contractor and all drafters of the Special Provisions take all due regard of the five FIDIC Golden Principles’.<sup>21</sup>

## Notes

- 1 FIDIC Conditions of Contract for Construction for Building and Engineering Works Designed by the Employer (2nd edn, 2017) (Red Book); FIDIC Conditions of Contract for Construction MDB Harmonised Edition for Building and Engineering Works Designed by the Employer (MDB Harmonised edn, 2010) (Pink Book); FIDIC Conditions of Contract for Plant and Design-Build for Electrical and Mechanical Plant and for Building and Engineering Works, designed by the Contractor (2nd edn, 2017) (Yellow Book); FIDIC Conditions of Contract for EPC/Turnkey Projects (2nd edn, 2017) (Silver Book).
- 2 Capitalised terms not otherwise defined have the meaning defined in the FIDIC Contracts.
- 3 Report by National Public Works Council (NPWC)/National Building and Construction Council (NBCC) Joint Working Party, ‘No Dispute Strategies for Improvement in the Australian Building and Construction Industry’ (May 1990) 7.
- 4 ‘Standard Conditions of Contract’ (2001) 4 *BDPS News* 1, 4.
- 5 See [www.consensusdocs.org/FooterSection\\_About/FooterSection\\_WhyConsensusDocs](http://www.consensusdocs.org/FooterSection_About/FooterSection_WhyConsensusDocs) accessed 18 March 2018.
- 6 Brian Eggleston, *The New Engineering Contract: A Commentary* (1996) 7.
- 7 Orgalime Turnkey Contract for Industrial Works.
- 8 International Chamber of Commerce Model Turnkey Contract for Major Projects (2007) [www.iccbooks.com/Product/ProductInfo.aspx?id=488](http://www.iccbooks.com/Product/ProductInfo.aspx?id=488) accessed 18 March 2018.

- 9 See [www.bimco.org/about-us-and-our-members/about-us/our-history](http://www.bimco.org/about-us-and-our-members/about-us/our-history) accessed 18 March 2018.
- 10 Leading Oil and Gas Industry Competitiveness (LOGIC) [www.logic-oil.com](http://www.logic-oil.com) accessed 18 March 2018.
- 11 HM Treasury, *The Green Book Appraisal and Evaluation in Central Government* <http://greenbook.treasury.gov.uk/annex04.htm> accessed 26 August 2008: ‘The governing principle is that risk should be allocated to whichever party from the public or private sector is best placed to manage it. The optimal allocation of risk, rather than maximising risk transfer, is the objective, and is vital to ensuring that the best solution is found’.
- 12 Department of Treasury and Finance Victorian Government, *Partnerships Victoria Updated Standard Commercial Principles* (2008) 99: ‘Both the government and the private party should seek to ensure that cost and adequate risk transfer are balanced as far as possible to achieve the best value for money on a particular project.’
- 13 US Department of Transportation Federal Highway Administration, *Risk Assessment and Allocation for Highway Construction Management* (2006) s 6.1.1 [www.international.fhwa.dot.gov/riskassess/risk\\_hcm06\\_06.cfm](http://www.international.fhwa.dot.gov/riskassess/risk_hcm06_06.cfm) accessed 26 August 2008: ‘A fundamental tenet of risk management is to allocate the risks to the party best able to manage them. The party assuming the risk should be able to best evaluate, control, bear the risk of, and benefit from its assumption.’
- 14 NPWC/NBCC Joint Working Party, ‘No Dispute Strategies for Improvement in the Australian Building and Construction Industry’ (May 1990) 6–7; Sir Michael Latham, ‘Constructing the Team’ (July 1994) Final Report 37.
- 15 AC Sidwell, RJ Kennedy and APC Chan, ‘Re-Engineering the Construction Delivery Process’ (2002) *Construction Industry Institute Australia Report*, 34.
- 16 Check List for One Sided Contracts (Japan International Cooperation Agency, 2011), 1.
- 17 The author was the principal drafter for TG15.
- 18 Guidance for the Preparation of Particular Conditions, 8.
- 19 Max W Abrahamson, ‘Risk Management’ (1983) 1 *International Construction Law Review* 241, 244.
- 20 Nael Bunni, ‘The Four Criteria of Risk Allocation in Construction Contracts’ (2009) 26 *International Construction Law Review* 4, 9.
- 21 Guidance for the Preparation of Particular Conditions, 8.

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