

Client Alert

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After 18 Years, FIDIC Updates EPC Contract Forms

When owners and contractors begin discussions on the form of EPC contract they propose to use, they (as well as other investors and lenders) would agree that the form must be "pro-clarity" whether or not the form is otherwise regarded as "pro-owner" or "pro-contractor". Even as they will inevitably be modified by the parties, contract templates that are clear, direct, and avoid ambiguities will often result in faster, less expensive, and less contentious negotiations and more productive working relationships.

In December 2017, the International Federation of Consulting Engineers ("FIDIC") launched the second editions of its Red Book (owner-designed), Yellow Book (contractor design-build) and Silver Book (turnkey project) model conditions for EPC contracts. Since 1999, the first edition of these model forms have been frequently used worldwide.

The 2017 forms may be more clear than their predecessors; however they are, on average, nearly double the length of the 1999 forms. Simplification was not a FIDIC priority: FIDIC has stated that it would not be appropriate to simplify the 2017 forms given FIDIC's essential goal of fair and balanced risk allocation. Instead, the new editions are meant to promote clarity, encourage the parties to exchange information more easily and settle disputes more quickly, and resolve various ambiguities and omissions in the 1999 forms. As parties consider whether to work with the 2017 forms, what important new provisions should they be mindful of? What critical issues are still open or unresolved?

We highlight below some key changes between the 1999 Yellow Book form (the "1999 Yellow Book") and the 2017 Yellow Book form (the "2017 Yellow Book"). This is not a complete list of changes, and as the 2017 forms are used by market participants, additional points and disputes will certainly arise. Parties are still free to modify the 2017 forms as necessary in the particular conditions and schedules. However, owners and contractors should carefully consider and discuss with counsel the legal consequences of using and modifying any of the 2017 forms for a specific project.

Expanded Role of the Engineer

In both of the 2017 Yellow Book and 1999 Yellow Book, the project "Engineer" (who is paid and hired by the owner) is required to act as an independent, neutral expert to approve certain contractor requests and resolve certain disputes between the contractor and the owner. The Engineer may exercise its authority specified in or implied from the contract without the owner's consent.

The 2017 Yellow Book now expressly provides that the Engineer is not required to seek the owner's consent before consulting with the parties to reach agreement or making a determination on any matter or claim. The owner is prohibited from imposing additional restrictions on the Engineer's authority. Additionally, the 2017 Yellow Book explains in much greater detail the process and procedures by which the Engineer gives approvals and resolves owner-contractor disputes.

However, since the Engineer is not a signatory to the EPC contract (in both versions of the forms), it is still unclear what actions the contractor may take if the Engineer is not acting neutrally pursuant to the EPC contract. Expansion of the role of the Engineer, which has been controversial since the original forms, may result in more disputes (unless the parties agree to modify the forms to exclude the Engineer).

Programs and Delays

- **Reporting Requirements:** The 2017 Yellow Book emphasizes the importance of tracking records, and submitting detailed progress reports and updated programs during the contractor's performance of the EPC contract. The construction program must include various details and be prepared using programming software stated in the "employer's requirements" section of the EPC contract.
- **Advance Warning:** This new clause is adopted from the 2008 FIDIC Gold Book, and is meant to help avoid disputes. Each party should inform the other party and the Engineer in advance of any known or probable events that may result in an increase of the contract price or a delay. Upon receipt of the warning, the Engineer may request the contractor to submit a proposal to avoid or minimize the effects of such events. However, it is unclear in the 2017 Yellow Book how many days in advance a party must give the warning and the consequences of failure to give such warning.
- **Termination for Contractor's Default and Delay Damages:** While the 1999 Yellow Book is silent on this point, the 2017 Yellow Book provides that (in the case of owner termination due to contractor's default) the contractor must pay the owner delay damages if "taking-over" has not been achieved and if the date of termination occurs after the "time for completion" date. In that case, delay damages must be paid for every day between the "time for completion" date and the termination date.
- **Concurrent Delay:** The 2017 Yellow Book introduces a "concurrent delay" (delay partially caused by both the owner and the contractor) provision. However, the 2017 Yellow Book does not include model language and leaves the provision to be negotiated by the parties. FIDIC explains in commentary that there is no standard international practice regarding how to address concurrent delay and, therefore, recommends that the parties obtain legal advice. This issue may be a recurring critical negotiation point.

Defects

- **Failure to Remedy Defects:** In the event of the contractor's failure to remedy defects, the 1999 Yellow Book provides that the owner has the option to perform the works by itself (or through a third party contractor) or to terminate the contract. In addition to those options, the 2017 Yellow Book provides the following options:
 - to treat the defective works as an "omission" from the original scope of works (similar to decreasing the scope of works through a variation) and reduce the contract price accordingly; or
 - to accept the defective works but charge the contractor for "performance damages" specified in the EPC contract. If there are no specified performance damages, the owner may choose a reduction in the contract price.

- **Latent Defects:** One of the most contentious and often-litigated EPC contract issues is the treatment of latent defects that arise after the expiration of the EPC contract's designated "defects notification period" (DNP). The 1999 Yellow Book is silent about defects or damages occurring after expiry of the DNP - resolution is left to the governing law. However, the 2017 Yellow Book provides that a contractor remains liable for latent defects for two additional years after expiry of the DNP.

Variations, Value Engineering, Costs and Lost Profits

- **Agreeing on a Variation:** Under the 1999 Yellow Book, the only requirement for a variation is that it must be "in writing" (including email), but the 2017 Yellow Book requires a variation to be in the form of a "notice" as defined in the EPC contract. Parties using the 2017 Yellow Book will need to carefully use the approved methods of communication to avoid disputes about whether a variation was officially agreed.
- **Value Engineering:** If the Engineer accepts a contractor-proposed variation that is time-saving or cost-saving (or provides some other project benefit), the 2017 Yellow Book requires the parties to share the benefit, costs and/or time saved between the parties. The 1999 Yellow Book is silent on this issue.
- **Changes in Costs:** The 2017 Yellow Book has deleted the sample formula for price adjustments for changes in cost, whereas the 1999 Yellow Book provides a sample formula. Under the 2017 Yellow Book, if the parties agree on price adjustments they will need to create or insert their own formula.
- **Lost Profits:** Although the 1999 Yellow Book notes certain events where the contractor is entitled to a "profit", it does not provide a specific, default profit amount. The 2017 Yellow Book now sets the default amount of the recoverable profit at 5% in most cases under a new definition of "cost plus profit" (unless otherwise provided in the contract).

Exceptional Events

- **Subcontractor Force Majeure:** The "Force Majeure" and "Employer's Risks" clauses in the 1999 Yellow Book have been combined and reorganized into "Exceptional Events" in the 2017 Yellow Book.

One important substantive difference relates to subcontractor force majeure. The 1999 Yellow Book specifically states that if the contractor grants force majeure (FM) rights to its subcontractors that are broader than the contractor's FM rights in the primary EPC contract, subcontractor FM shall not excuse the contractor's non-performance under the primary EPC contract. This clause has been deleted in the 2017 Yellow Book, and owners who wish to retain that protection should negotiate and insert a similar clause.

Indemnifications and Fit for Purpose

- **Reciprocal Indemnities:** The 2017 Yellow Book contains two separate indemnification clauses: indemnities by the contractor and indemnities by the employer. Both parties' respective liability is reduced proportionately based on the other party's contribution to the damage, loss or injury.

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- **"Fit for Purpose"**: In the 2017 Yellow Book, the contractor now has expanded indemnification obligations in relation to design, namely, the works must be "fit for purpose".

In the 1999 Yellow Book, the term "fit for purpose" is required to be defined in the contract in general (i.e. not required to be defined in the "employer's requirements" section). If the owner's intended purpose is not defined expressly, it often leads to a dispute over interpretation of the exact meaning of the "purpose" and such dispute will likely focus on defining the normal purpose used in the industry for the similar type of works.

In the 2017 Yellow Book, if "fit for purpose" is not defined, the works must be fit for their "ordinary purpose". This change may benefit the owner, but the meaning of "ordinary purpose" is ambiguous. If a contractor desires to only be held to specific, expressly defined obligations contained in the EPC contract, it will need to negotiate for the removal of the term "fit for purpose" (or at least the default language "ordinary purpose") or specify the purpose in the "employer's requirements" section.

Claims and Disputes

- **Time Bar for Claims**: Under the 1999 Yellow Book, contractors must follow certain procedures for claims against the owner and are subject to a time bar on claims. That continues in the 2017 Yellow Book, but the owner, for the first time, is also subject to the same claim procedures and time bar. This is a significant change that (even if acceptable to an owner) may not be acceptable to project lenders.
- **Dispute Avoidance/Adjudication Board (DAAB)**: The 1999 Yellow Book provides for the possible use of a Dispute Adjudication Board (DAB); i.e., a standing committee containing one or three adjudicators (qualified dispute resolution specialists) nominated by the parties to resolve disputes prior to arbitration. However, in practice, DABs are rarely used as such a standing committee would impose additional costs on the parties.

The 2017 Yellow Book introduces the DAAB and emphasizes its importance. For example, either party may terminate the contract if the other party fails to comply with a decision of the DAAB. Such failure constitutes a "material breach" (and if the owner is the defaulting party, the contractor also has a right to suspend the works).

Additionally, under the 2017 Yellow Book, arbitrators may consider a party's failure to cooperate with the other party in using a DAAB when deciding any award regarding the costs of arbitration.

Future of the 2017 Forms?

Will the 2017 Red, Yellow, and Silver Book forms be as widely used as (or largely replace) the 1999 forms? Much will depend on whether project lenders consider the new forms "bankable", and investors will also closely monitor any legal and commercial disputes as the forms are put into practice.

We will continue to monitor developments relating to the 2017 FIDIC Red, Yellow, and Silver Books and will provide further updates.