

# LEGAL ASPECTS OF USING FIDIC CONTRACTS IN INTERNATIONAL CONSTRUCTION PROJECTS IN UKRAINE

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## I. INTRODUCTION

Recent years have seen Ukraine's significant progress in reforming different sectors of its economy, including the construction industry, which has been a challenging task, given the historical context in which Ukraine has found itself. It is common knowledge that the Soviet era was the realm of state monopoly, overregulation and centralisation, and the Ukrainian construction industry embodied all of the above. During those times and the years following, practically no room was left for independent technical supervision, consultancy or project management, private ownership or funding. Absent were competition, market-based procurement, bidding price mechanisms or other components of a liberal market. The elements of this onerous approach inherited from the USSR still persist in many post-Soviet countries, including Ukraine.

Since the launch of the construction reform in Ukraine, new market instruments and practices have begun to be introduced in Ukraine. These include: certification of professionals by industry associations; liberalisation of mandatory rules; facilitation of permit and licensing procedures; reallocation of powers from centralised governmental agencies to local self-governing authorities; and sharing state control functions with non-governmental self-governance associations. The industry is digitised, and becomes ever more transparent with the gradual introduction of electronic services and online public registers (such as the register of property rights to real estate, construction permits, construction licences, land zoning documents, public procurement portal, etc). This contributed to a significant improvement in the regulatory framework, evidenced by Ukraine's rocketing score in World Bank's "Ease of Doing Business" over the

past five years.<sup>1</sup> The signing of the EU-Ukraine Association Agreement in 2014 provided another strong impetus for Ukraine to intensify this reform and align its regulatory and operational environment with international standards.

In Ukraine, there is no codified legislative act that regulates on a comprehensive basis all of the principal aspects of construction, such as a city planning code.<sup>2</sup> The principal acts of legislation governing construction issues are the Civil Code of Ukraine (“Civil Code”) and the Commercial Code of Ukraine (“Commercial Code”), enacted in 2004. As well as the above laws, there are also numerous laws and by-laws governing licensing, construction permits, commissioning (putting into operation) of finished property, responsibility in construction, etc. Construction standards and norms are embraced by the so-called “DBNs” (the state construction norms). This is an odd conglomeration of the old-fashioned regulations inherited from Soviet times and modern, progressive regulations.

In Ukraine, there are no mandatory standard forms of construction contracts.<sup>3</sup> However, particular regard should be given to Regulation of the Cabinet of Ministers of Ukraine No 668 approving “The General Conditions for Conclusion and Performance of Capital Construction Contracts” (“Regulation No 668”), adopted in 2005. Regulation No 668 requires that these general conditions should be “mandatorily taken into consideration” irrespective of the sources of construction funding or the form of ownership of an employer or a contractor or sub-contractors. An exemption is made for the rules established by the international treaties of Ukraine, which override the provisions of Regulation No 668, as is, for example, the case with FIDIC contracts concluded by the international finance institutions (“IFIs”) under the international agreements of Ukraine. The general conditions as set out in Regulation No 668 should not be confused with the General Conditions of FIDIC contracts, which are compounded by the Particular Conditions. Regulation No 668 does not provide for a binary structure, and there are no references to particular conditions as is the case with FIDIC contracts.

FIDIC contracts are usually used in the international construction projects funded by IFIs. The EBRD, the EIB and the World Bank feature as the most active donors to such projects and, it is through these projects that the use of FIDIC contracts in Ukraine is promoted. FIDIC’s heritage is not well-known in Ukraine, except for the 1999 Conditions of Contract for Construction for Building and Engineering Works designed by the Employer (“Red Book”)

<sup>1</sup> For the general ranking in “Ease of Doing Business”, Ukraine ranks 76 out of 190 in 2018 vs 152 out of 183 that it held in 2012. For the sub-ranking “Dealing with Construction Permits”, Ukraine ranks 35 out of 190 in 2018 vs 180 out of 183 in 2012. For the sub-ranking “Registering Property”, Ukraine ranks 64 out of 190 in 2018 vs 166 out of 183 in 2012.

<sup>2</sup> There is a draft of such code, yet the prospects of its adoption are not clear.

<sup>3</sup> There is a non-binding, exemplary form approved by the central authority for construction, which parties can deviate from.

and the Conditions of Contract for Plant and Design-Build for Electrical and Mechanical Works Designed by the Contractor (“Yellow Book”), which are typically used in the IFI-funded projects in Ukraine.<sup>4</sup> Other documents developed by FIDIC (such as the new contract forms developed by FIDIC in 2017, “The FIDIC Contracts Guide”, “FIDIC Procurement Procedures Guide”, “Risk Management Manual”, etc.) are practically unknown, and are not used in Ukraine. Other international practices promoted by FIDIC, such as Building Information Modeling (BIM) are not well-known in Ukraine, and used only by some international engineering companies represented in Ukraine. Public authorities have no methodologies or other instruments at their disposal which could guide them through different practical aspects related to the use of FIDIC contracts, such as time or cost management, variations and other aspects of contract administration and project management, quantification of claims and claim management procedures, evaluation criteria and other public procurement issues, etc. Greater use of FIDIC contracts in Ukraine is hampered by the fact that there are no official translations of FIDIC forms of contract into the Ukrainian language.

Based on the fundamental principle of the freedom of contract, which is officially recognised in Ukraine, FIDIC contracts as well as other forms of contract can be used, unless they are expressly prohibited by law or deviate from mandatory provisions of Ukrainian law. Whether a provision is mandatory is implicit in either its contents or the substance of the relationship between the parties. It is not always possible to clearly differentiate between the discretionary and mandatory provisions of Ukrainian law. Mandatory provisions are usually understood to include, amongst other things, licensing, certification and permit procedures, technical regulations and standards, immigration and labour requirements, environmental and safety issues, and taxation.

Apart from regulatory and other mandatory requirements and the Ukrainian public order issues, it is necessary to account for the differences between FIDIC contracts and the law of contract in Ukraine, as discussed below. The differences are rooted in the historical background of Ukraine and the peculiarities of the civil law system to which Ukraine adheres. In civil law jurisdictions, there are difficulties with the interpretation and implementation of many terms, notions and principles of common law underlying FIDIC contracts (such as “time is of the essence”, “dispute adjudication board”, “variations”, “value engineering”, “early warning”, “substantial completion”, “constructive acceleration”, “time at large”, “experienced contractor” or “determinations”).

<sup>4</sup> For this reason, in this article the provisions of Ukrainian law on construction contracts will be compared against FIDIC’s 1999 “Red Book” and, in some instances, “Yellow Book”.

## II. FIDIC CONTRACTS IN THE CONTEXT OF UKRAINIAN LAW

### (a) Allocation of risks amongst parties

In complex and long-term projects, which are typically seen in the engineering and construction industry, it is essential that risks should be allocated and managed efficiently. To achieve such efficiency, the risk should be allocated to a party best able to control and administer this risk.

In this regard, the FIDIC's Procurement Procedures Guide states that:

- (a) construction and engineering are high-risk industries;
- (b) management of risks has overriding importance;
- (c) every risk must be allocated to one or other party;
- (d) a risk cannot be "left hanging in the air";
- (e) practice over many years has shown that sensible and balanced risk allocation results in the lowest overall total cost for completed projects.

Guidance on the concept of risk or the principles of risk allocation is not well-developed in Ukrainian law and practice, and insufficient to meet the needs of complex construction projects. Such provisions as there are in Ukrainian law dealing with risks and their consequences are unsystematised, broadly worded, and do not provide clear guidance to parties as to their entitlement to time extension, additional payment and composition thereof (cost and/or profit), and other remedies.

In addition, local forms of contract fail to provide efficient and instrumental solutions to parties which would help them efficiently administer risks and contingencies should they materialise.

Subject to the above constraints, attempts can be made to frame most risks within the general provisions of the Civil Code, such as, for example, the following:

- parties should take account of reasonability and fairness when entering into a contract (Article 652);
- parties can claim an amendment or dissolution of a contract in court in the event of a material change in circumstances, and a court should take into account a fair allocation of costs incurred by parties when passing its decision (Article 652(3));
- a debtor has the right to delay performance in the event of a creditor's delay (Article 613(2)); or
- establishment of party's responsibility for full indemnification of damages caused to the other party (Article 883(2)).

Clearly, these general provisions lack certainty or clarity and, in the absence of clear contractual provisions, and parties failing to agree on an acceptable solution, their practical significance is often reduced to the foundation of claims in court.

The allocation of risks is dependent on the nature and peculiarities of a particular project as well as the delivery method selected by parties with account of design responsibility, contract administration approach and contract price formation. To exemplify the differences in approach to risk allocation, below we compare the provisions of Ukrainian law against those of the “Red Book”, which is based on the delivery method of general contracting, or “Design-Bid-Build”.

Sub-clause 17.3 (*Employer’s Risks*) of the “Red Book” enumerates the risks which are allocated to an employer, such as war, invasion, act of foreign enemies; terrorism, revolution, insurrection, military or usurped power, or civil war, radioactive contamination, design of any part of the works by the employer’s personnel or by others for whom the Employer is responsible, any operation of the forces of nature which is unforeseeable and others.

Apart from the above, an employer bears the following risks: unforeseeable physical conditions (sub-clause 4.12), discovery of fossils, coins, articles of value or antiquity (sub-clause 4.24) and other risks covered by force majeure (sub-clause 19.1). Upon the occurrence of risks allocated to an employer, and to the extent that they result in loss or damage to works, goods or contractor’s documents, a contractor becomes entitled to claim (a) an extension of time for delay, and (b) payment of costs that the contractor incurs to rectify loss or damage. In the events listed in sub-paragraphs (f) and (g) of sub-clause 17.3 above, reasonable profit on the cost should also be included.

Unlike FIDIC contracts, under Ukrainian law it is primarily the Contractor who bears the risks relating to insuperable force<sup>5</sup> before the property is transferred over to an employer, with some costs, however, allocated to an employer. In particular, Articles 855(1) and 879(5) of the Civil Code maintain that, in the event that, before an object of construction is transferred over to an employer, destruction or damage of the object (or works) occurs which is caused by insuperable force,<sup>6</sup> or it is impossible to finish works for other reasons beyond parties’ control, a contractor cannot claim payment of work or incurred costs, unless a contract provides otherwise; if there is a need for suspension (conservation) of construction for reasons beyond the parties’ control, an employer should pay the Contractor for such works and compensate related losses. A decision on continuation of construction is left for parties to agree upon.

The law is silent on the entitlement to an extension of contract upon the occurrence of this risk. Where a risk of accidental damage or loss is shifted to an employer by contract, an employer should promptly decide on feasibility and the terms of continuation of construction, and compensate a contractor

<sup>5</sup> Insuperable force is closely comparable to force majeure as defined in FIDIC contracts.

<sup>6</sup> For more details please refer to section II(e).

for additional costs related to the rectification of the consequences of accidental damage or loss of a construction object.

When it comes to a discovery of fossils, artefacts or similar articles of value or antiquity, the legislature is concerned primarily about the “public interest” requiring the parties notice relevant authorities, and it does not provide guidance to contracting parties as to how to settle the consequences of this risk. This requires parties to think ahead and develop contractual solutions. This is particularly relevant, given that it can take public authorities a long time to take action on the issue. Only a limited guidance can be found in law, and it relates to the conservation of construction for the reasons beyond parties’ control. Under Article 879(6) of the Civil Code, where there is a need for conservation of construction, an employer should pay contractor’s works performed before suspension and compensate the losses related to such suspension. Conservation is a special formal procedure under Ukrainian law, which is rarely used, and it does not cover the variety of consequences that can be faced by parties as a result of discovery.

Certain risks can be shared by parties, with a combination of remedies available to both parties. For example, under sub-clause 8.5 (*Delays Caused by Authorities*) of the “Red Book”, a contractor who acted diligently is entitled to claim an extension of time, but is not entitled to claim additional costs from an employer. Ukrainian law is silent on which party should bear the risk of delay caused by authorities. In practice, certain dealings with authorities may require close cooperation and the joint action of both the Employer and the Contractor (for example, when obtaining approval of amendments to design documentation, or dealing with control inspections); it would then be difficult to identify the consequences, unless a contract clearly allocates the risk to one party or another, or both, with the identification of the consequences for each party in the event of a shared risk.

Exceptionally adverse climatic conditions are another example of a shared risk. According to sub-clause 8.4 (*Extension of Time for Completion*) of the “Red Book”, in the event of exceptionally adverse climatic conditions a contractor is entitled to claim an extension of time for completion. In Ukraine, adverse climatic conditions are not singled out from other events of insuperable force and are, thus, subject to the same consequences as those applicable to insuperable force.

Risks related to the site data are, in the “Red Book”, allocated to the contractor. Under sub-clause 4.10 (*Site Data*), a contractor is deemed to have inspected and examined, to its satisfaction, a construction site, its surroundings, site data and other available information, and is responsible for interpreting all site data; it is also deemed to have obtained all necessary information as to risks, contingencies and other circumstances which may influence or affect works. Consequently, the Contractor



bears the associated risks, including those arising out of insufficiency or inaccuracy of data, or their misinterpretation. Ukrainian law takes a similar approach in allocating this risk to the contractor, although it does not clearly identify the consequences of this risk for parties.

Those other contractor's risks set out in FIDIC contracts which relate to proper execution and completion of works – for example, under sub-clause 4.1 (*Contractor's General Obligations*) of the “Red Book” generally correspond with the provisions of Ukrainian law on the obligations of a contractor to duly perform works. An employer is entitled to claim a proportionate reduction in cost or free rectification of defects within a reasonable term, or indemnification of its costs involved in the rectification of defects (where an employer's right to rectify is established by law), or terminate in the event of substantial defects.

The allocation of risks related to a contract price is largely dependent on the type of the contract pricing (whether fixed or approximate); this issue will be discussed in greater detail in section II(b) below.

#### **(b) Contract price and timing. Variations and contract amendments**

Ukrainian approaches to cost and price formation in construction are historically based on a somewhat different philosophy than that of FIDIC contracts. By default, a contract is deemed to be based on a fixed price and fixed cost estimates, unless the parties expressly agree otherwise. Ukrainian law distinguishes between a fixed and an approximate contract price (and the corresponding fixed and approximate cost estimates), and this has a major impact on the allocation of risks between parties. A fixed contract price should remain unchanged for the entire volume of construction, and does not allow for adjustments other than by the agreement of parties in the instances provided by law or contract. An approximate (or “dynamic”) contract price can be modified whenever there is a need to account for adjusted volumes of works, costs of resources or other factors as may be set out and defined in contract.

If the parties require an approximate contract price, they should expressly indicate this in a contract, or otherwise the contract price is deemed fixed. FIDIC contracts are generally based on a somewhat different philosophy, the assumption being that adjustments are a natural outcome and component of a construction price, rather than an exception, and that the price is intended to be adjusted in most cases (for example, through variation or re-measurement); even under a lump sum contract adjustments are allowed.

The law expressly provides that, if there is a need to exceed a fixed contract price, it is the contractor who should bear all related costs; the Contractor cannot claim an increase in costs, if, at the date of signing of a contract the parties could not forecast any changes in the full volume of

works or necessary costs. However, in the event of a substantial increase in the value of materials, plant, or services provided by third parties to a contractor, the Contractor can claim an increase in price, and if the employer does not accept it, the contractor can claim the dissolution of a contract. It is, therefore, important that parties determine, under a fixed price contract, the grounds for a price increase as well as the procedure for price adjustments.

Where budget funds are used to finance a construction project, or the state guarantees are issued under a fixed price contract, it is necessary to take account of the “Rules of Determination of Construction Costs” approved by the state standard rules (the so-called “DSTU”) No Д.1.1-1:2013, which determine the following grounds for adjustment:

- a change of design by an employer;
- insuperable force; or
- a change in legislation which is mandatory for use and entails changes in the cost.

Similar grounds are often used in construction contracts financed with private funds, and parties are free to modify or extend this list.

Where a contract is based on an approximate price, parties should state in a contract the procedure of cost adjustments which will apply during the performance of works. If there is a need to exceed an approximate budget, the Contractor should inform an employer in due time or, failing that, it should perform works at the cost established by a contract; payment for additional costs incurred without due notice to the Employer cannot be claimed.

When contracting with a public employer, it should be remembered that payment by a public employer under a contract can be subject to different restrictions and procedures. Price formation is generally over-regulated, and is not indicative of market values and practice. Payments which are financed from relevant budgets should be forecast in the annual budget estimates (including additional costs, damages or penalties).

As a matter of practice, contractors have often faced delays in payments due to bureaucracy and lengthy approval processes, even where a prompt response is required in the interest of the efficiency of a construction process. There are approved forms of source and accounting documents which are required to be used by public employers for the acceptance and payment of works, (for example, КБ-2в “Act of acceptance of construction works performed” and КБ-3 “Certificate of payment of the construction works performed and costs”). The list of these approved forms was amended in 2013 to include forms suitable for use in projects funded by IFIs. However, where projects are funded from budgets, parties should use other forms, which do not match the framework of FIDIC contracts.



Amendment of a construction contract, as a general rule, requires the agreement of both parties. Because both the contract price and the term (timing) of the performance of works are essential terms of a contract under Ukrainian law, in order to change these the parties, as a general rule, need to sign an addendum (a supplementary agreement) in the same form as their original agreement.

Where the price or the timing is changed under FIDIC contracts, parties may seek to limit the authorities of an engineer, through the Special Conditions and/or a consultancy agreement with an engineer, by requiring approval from an employer to effectuate any variations resulting in the extension of time, additional costs or other implications for parties. Public employers will usually insist on signing annexes to an agreement in such cases.

The concept of a self-adjusting contract with the involvement of a third party (such as a consulting engineer) is not well-known in Ukraine. Ukrainian law does not define grounds for variations or practical consequences for parties in terms of cost or timing, nor does the law distinguish between variations and amendments to a contract.

There are instances when Ukrainian law expressly recognises the right of a party to amend the Contract (which resemble the concept of “variation” under FIDIC contracts); these include, for example, the Employer’s right to change design documentation. However, if this implies a change in the nature of works and increases the contract price by more than 10 per cent, an employer should obtain a contractor’s consent; if the contractor does not then accept the change, it can withdraw from a contract and claim damages from the employer.

In practice, parties will normally sign an additional agreement following a “variation” instructed by the Employer, for example, to change design documentation or in other events, even though a party’s right to make changes may be already provided by law or contract. In line with this approach, in FIDIC contracts with public employers it is often seen that powers of a consulting engineer are limited by the need to obtain pre-approval from an employer and formalise the outcome of the Engineer’s determinations (including variations) in additional agreements to be signed by both parties.

Regulation No 658 (item 19) expressly states that the term (timing) of construction can be changed, supported by relevant amendments to a contract, in the event of amendment of design documentation, third party actions and insuperable force as well as in certain other instances affecting construction. However, it is necessary to obtain an employer’s consent and amend a contract before such extension can be effectuated. This does not provide much practical value to a contractor, other than claiming its rights in court, should the parties fail to agree and sign an addendum to a contract.<sup>7</sup>

<sup>7</sup> For further discussion on risk allocation issues, please see section II(a).

As a matter of practice, it should be noted that employers are often reluctant to grant extensions of time, and will allow for periods shorter than those requested by contractors, even where both parties are clear that it would not be possible to complete a project within the allowed term of extension. In the IFI-funded projects, the IFI's procurement rules are used (where available), which prevail over local procurement procedures, and provide greater flexibility for changing the contract terms. For the local procurement framework, substantial amendment would be necessary to allow for a self-adjusting contract, such as those of FIDIC.

**(c) Taking-over of works and completion. Acceptance and commissioning of property**

Ukraine is a civil law country and, as in Germany and other civil law jurisdictions, it supports the concept of "acceptance" of works by an employer.

Under Ukrainian law, the date of completion of works (construction of an object) is deemed to be the date of acceptance of works by an employer. The concept of "acceptance" is key, as it entails important legal consequences such as shifting the risk of accidental loss or damage to works to an employer as well as the transfer of title ownership to finished works (a constructed object) to an employer, where a contractor is deemed to be the owner before such acceptance.<sup>8</sup> Acceptance also marks the time when the contract price becomes due for payment, unless parties agree otherwise. Of special notice is the question of when the statute of limitations and the statutory guarantee (defects liability) term commences. Under Ukrainian law this is related to the acceptance of works. Unless the acceptance is framed within the contractual procedures (typically, the taking-over of works), it can give rise to controversies and disputes.

At acceptance, the Employer should examine and check the works for apparent defects; acceptance effectively constitutes a waiver by an employer of such claims.<sup>9</sup> An employer who accepts works without examination forfeits its right of claiming apparent defects in works. In practice, parties will often want to expressly reserve the right to claim, which should survive the acceptance and indicate that acceptance does not amount to a waiver of claims by an employer. However, the Ukrainian courts may disregard such contractual waiver, depending on the circumstances of the case.

Acceptance is formalised by the signing of a transfer and acceptance act (protocol) by an employer and a contractor. Defects, if identified by an employer, are usually stated in this act, and an employer may instruct a contractor to rectify within the term indicated by an employer. A sectional

<sup>8</sup> For the discussion on the statute of limitations and the guarantee term please see section II(e).

<sup>9</sup> Apparent claims are understood as claims that could be identified by an employer during the ordinary manner of inspection and acceptance of works.

acceptance (acceptance of sections or stages of works) allowed under FIDIC contracts is also possible under Ukrainian law.

The concepts of “partial acceptance”, “provisional acceptance” or “substantial acceptance” are not well-known in Ukraine. These are more relevant to common law jurisdictions where a distinction is made between the completion of works – which allows use of property for an intended purpose (substantial completion) – and full performance under a contract. It is around these concepts that FIDIC contracts are formed as regards completion and takeover of works. There is no provision in Ukrainian law for a two-stage process – as set out under the “Red Book” or “Yellow Book” – which involves the issuance by an engineer of a taking-over certificate and then of a performance certificate. For this reason, the relevant provisions of FIDIC books are usually modified through the Particular Conditions in order to take into account local peculiarities, including the mandatory procedures of commissioning (putting into operation) of property.

Commissioning certifies that the property has been constructed in accordance with design documentation and the applicable construction rules and standards. It is not until the commissioning that a property can be used and operated. The commissioning procedures are within the domain of public (mandatory) law and, as such, they cannot be changed by agreement of the parties. Property falling under all class consequences (except for CC1<sup>10</sup>) is commissioned through the issuance by the relevant authorities (currently, the state architectural and construction control bodies) of a certificate. The authorities should issue a certificate within 10 business days following receipt of submission. The submission should include the so-called “act of readiness for use”, signed by an employer, a general contractor, a designer, the contractor(s) (and sub-contractors and insurers, if any).

In FIDIC contracts, parties typically modify sub-clause 10.1 (*Taking-Over of the Works and Sections*) of the General Conditions by the Particular Conditions. Under the modification, the taking-over will be understood to include, amongst other conditions, the issuance of a certificate (or registration of a declaration of readiness, as the case may be), the transfer of all design and construction documentation to an employer, and testing and compliance with all acceptance and commissioning procedures mandated by Ukrainian law. Furthermore, it is often required in contracts that an employer should approve the taking-over certificates before their issuance by an engineer. This provides additional control to an employer, and corresponds to the common understanding of an employer being a party who should accept works, which is defined in Ukrainian law. In some other contracts based on FIDIC forms, a taking-over certificate was seen as equivalent to the act

<sup>10</sup> Objects classified under an insignificant consequence class (CC1) are commissioned by way of registration of a declaration of readiness for use submitted by an employer.

of readiness for use issued by the authorities, which was plainly not the intention under FIDIC contracts.

Notably, all the above modifications to FIDIC contracts aimed at integrating the elements of the “acceptance” concept relate to the taking-over of works, and not the performance phase, even though a performance certificate issued by an engineer is deemed to constitute acceptance of works under sub-clause 11.9 (*Performance Certificate*) of the “Red Book” or “Yellow Book”. This is because the taking-over of works entails major legal consequences that can be compared to acceptance in Ukrainian law.

#### **(d) Termination and withdrawal from contract**

A party’s right to terminate under a contract should be distinguished from its right to terminate at law. Under Article 849(4) of the Civil Code, an employer is entitled to withdraw from a construction contract at any moment prior to completion of works, having paid a fee to a contractor for the works performed and having indemnified a contractor for the damage<sup>11</sup> caused by termination of the contract. This can amount to what is called “termination for convenience” under sub-clause 15.5 (*Employer’s Entitlement to Termination*) of FIDIC contracts (i.e. where there has been no default by the Contractor). Ukrainian law does not specify any procedures and consequences other than those stated in Article 849(4) of the Civil Code. Consequently, relevant procedures and consequences set out in FIDIC contracts can be a workable solution, as they do not contradict Ukrainian law in any material aspect.

When it comes to a termination “for cause”, the provisions of the Civil Code concerning the right of an employer to unilaterally withdraw from a construction contract are worded broadly. They include the following instances:

- if a contractor does not commence works on time, or performs so slowly that it becomes obvious that timely completion becomes impossible, or that the work cannot be properly performed and a contractor does not eliminate defects within the term appointed by an employer (Article 849(2));
- if additional works are necessary which entail a substantial increase in the approximate cost estimate, and an employer does not accept the Contractor’s offer of an increase in the budget (Article 844(4)); or
- if there are substantial deviations from contract terms, or material defects (Article 852(2)).

The law does not further specify the nature or thresholds for materiality or substantiality or describe the procedure for unilateral withdrawal from

<sup>11</sup> For the concept of “damages” under Ukrainian law, please see section II(d).

a contract in the above instances. Parties may want to develop relevant grounds and procedures in a contract with the aim of avoiding ambiguities or controversy. From this perspective, a workable solution can be found in the provisions of sub-clause 15.2 (*Termination by Employer*) of the “Red Book” or “Yellow Book”, which establish relevant grounds and procedures – whether termination through a 14-day prior notice, or with immediate effect (for example, in the event of contractor going into insolvency or receivership).<sup>12</sup>

Unlike an employer, a terminating Contractor is not entitled to terminate for convenience under FIDIC contracts. Sub-clause 16.2 (*Termination by Contractor*) of FIDIC contracts entitles a contractor to terminate if: an engineer fails to issue the relevant payment certificate, an employer fails to pay or substantially fails to perform his obligations under a contract, there is a prolonged suspension affecting the whole of the works, or in instances of insolvency (liquidation, bankruptcy or receivership).

Under the Ukrainian Civil Code, a contractor is entitled to terminate a contract in the following instances:

- if it is impossible to use materials or plant provided by an employer without compromising the quality of the works performed (Article 879(3));
- if an employer wishes to amend design and cost estimate documentation, entailing the need for performance of additional works of a value exceeding 10 per cent of the original cost estimate, and a contractor does not accept to perform such works (Article 878(2)); or
- if an employer fails to replace faulty materials or plant that it procured, to change its orders or instructions, or to eliminate other circumstances which threaten the quality or fitness of the result of works (Article 848(1)).

In addition, Article 848(2) of the Civil Code obliges a contractor to withdraw from a contract if the use of faulty or inappropriate materials, or compliance with the employer’s orders or instructions, threatens the life or health of people or may entail a breach of environmental, sanitary or safety rules or other requirements. At the same time, Regulation No 668 uses far less exacting wording, and puts it as a right, and not an obligation, of a contractor to withdraw from a contract in the above instance. This statutory provision, worded as it is in rather broad and vague terms, may create exposure and uncertainty for an employer. In practice, however, contractors are usually interested in continuing with projects and seeking

<sup>12</sup> In its Survey Letter No 01-06/374/2013 on the practice of dispute resolution in cases related to contractor agreements, issued in 2013, the Higher Commercial Court of Ukraine stated that an employer’s right to unilateral withdrawal from a contract cannot be limited. Consequently, relevant provisions of Ukrainian law can be considered as mandatory, and can be invoked in addition to the contractual provisions.

amendments to the overlying contract to do so, rather than terminating a contract.

Ukrainian law does not provide detailed guidance on the consequences and procedure of a contractor's withdrawal from a contract, other than general wording on the indemnification of damage.

As a general observation, parties should consider including provisions in their contracts expressly setting out the grounds and procedures relevant to unilateral withdrawal from a contract by either party. Relying solely on the Ukrainian law for the ability to unilaterally withdraw from a contract can be risky; this remedy is limited, and does not cover all practical instances where this may be needed (for example, insolvency, or substantial or continued breach by the other party). The procedures and consequences in the event of withdrawal from a contract by either party are not spelt out in law, and FIDIC contracts are instrumental in providing better, and more practical, guidance to parties to follow in the event of termination of a contract.

**(e) Liability and guarantee issues: grounds, exemptions or limitations, force majeure, decennial liability, defects liability period**

It is common practice to limit liability in international construction contracts. Under FIDIC contracts, the liability of parties is usually limited to the amount of a contract price, except in instances of fraud, deliberate default or reckless misconduct. (see, for example, sub-clause 17.6 (*Limitation of Liability*) of the "Red Book" or "Yellow Book").

Ukrainian law is based on the principle of full indemnification of damages, unless otherwise established by law or contract. In respect of construction contracts, no limitation of liability is established by law. According to Article 883 of the Civil Code, a defaulting contractor should indemnify damages in full, and should pay penalties established by law or contract. Article 226 of the Commercial Code provides for the full indemnification of damages, unless otherwise established by law or contract. Consequently, although not limited by law, liability can be limited by contract if the parties so agree. Liability cannot be limited or excluded for a deliberate breach of obligation, and provisions on limitation or exemption from liability for such breach are null and void under Ukrainian law.

Damages are normally understood to include both actual damages and loss of profit. Loss of profit should be thoroughly proven, and courts tend to take a measured approach, for example, by associating lost profit with the amount of an outstanding balance of a contract price, which an injured party should have received were it not for a contract breach or cancellation.

In practice, parties often want to limit liability by contract. This cannot be included, however, should a claim for damages be brought before the courts, a court can find the contractual limitations on liability



unenforceable, depending on the circumstances of the case, and rule on the full indemnification of the damages proved.

According to Article 322(1) of the Commercial Code, a party in breach of obligations under a contract for capital construction works should pay penalties, and indemnify damages to the other party for the balance not covered by penalties, unless otherwise established by law. Regulation No 668 provides that penalties, if established by contract, should be paid in full in addition to the indemnification of damages. Therefore, it is possible to claim penalties in addition to damages. It should be noted, however, that Ukrainian courts usually take an evaluative and critical approach when assessing the amount of damages or penalties to be awarded to an injured party, irrespective of the provisions of the Contract. The court may reduce or dismiss claims for damages, where not proven or considerably in excess of the actual damages incurred, or reduce penalties if they are excessive, unreasonable or overly burdensome on a defaulting party.

Ukrainian law does not expressly incorporate fundamental concepts relevant to common law such as the duty of care, tort or negligence. The concepts of “time at large” and “constructive acceleration” are not familiar, and not used, in Ukraine. As regards such remedy rooted in common law as delay damages, there used to be a provision in Ukrainian law comparable to delay damages, but then it was deleted.<sup>13</sup> In its previous reading, Article 225(5) of the Commercial Code provided that parties could agree in advance on the amount of damages to be indemnified, either as a lump sum or interest. Even when it was set by law, Ukrainian courts required the amount of damage incurred to be proven, whatever the provisions of a contract. By way of example, in Case No 9/40/07 upon the claim of Municipal Enterprise “Vodokanal” to LLC “Trust “Zaporizhbud” regarding the indemnification of damage under the contract for the procurement of works for the reconstruction of the Dnipro Water Supply Station (DVS-1) in the city of Zaporizhia, which was based on the FIDIC “Red Book”. The court maintained that the indication of delay damages in a contract does not relieve a party from the duty of proving the occurrence of damages as a result of a breach of obligations by the other party.

This notwithstanding, an argument can be made for invoking delay damages as an additional security remedy established by contract. Article 546(2) of the Civil Code allows the use of such other security remedies established by law or contract, apart from the security remedies expressly established by the Civil Code (such as a penalty for delay, surety, guarantee, pledge, retention or deposit).

Ukrainian law establishes debtor’s liability for a breach of its payment obligations. Under both the Civil Code (Article 625) and the Commercial Code (Article 229), a debtor cannot be released from liability for the impossibility of performance of a payment obligation, and must indemnify

<sup>13</sup> For a discussion on delay damages, please see section II(d).

a creditor for damages and pay penalties established by law. Penalties for delay of payment are commonly used in Ukraine, and take the form of interest accruing on the amount of outstanding payment. The maximum statutory threshold for penalties for the delay of payment obligations amount to the double discount rate established by the National Bank of Ukraine ("NBU"), effective during the term for which a penalty is due. Based on the current NBU's discount rate of 12.5 per cent p.a., the maximum amount of penalties due for the delay of payment is set at 25 per cent p.a.

A special limitation term of one year is established for claiming penalties (fines) under Ukrainian law. It can be extended by agreement of parties, but cannot be reduced. Therefore, should parties wish to allow for a continued period of delay payment or other penalties exceeding one year, they should make provision to this effect in the Particular Conditions of FIDIC contracts.

The general statute of limitations in Ukraine states a period of three years which, as a general rule, commences from the date a person becomes aware – or should have become aware – of a breach of its right(s). Parties can extend this term by agreement, but cannot reduce it. In certain cases, special statutes of limitation are established by law as in the case of claims for penalties (fines).

Article 322(3) of the Commercial Code establishes the extended statute of limitations during which claims can be brought arising out of improper quality of works under a contract for capital construction, as follows:

- one year for claims regarding defects of non-permanent buildings; and two years where such defects cannot be revealed during the usual course of works' acceptance;
- three years for claims regarding defects of capital structures; and 10 years where such defects could not be revealed during the usual course of works' acceptance; and
- 30 years for claims regarding indemnification of damages caused to an employer due to a contractor's wrongful act that inflicted destruction or accidents.

The statute of limitations in the above cases commences from the date of acceptance of works by an employer. The law does not clarify whether that is the interim or final acceptance; however, it would be reasonable to suggest that, as a general rule, it is the final acceptance that counts.

Article 322(3) of the Commercial Code does not specify the period during which construction project players can be held liable under an extended statute of limitations (designers, architects, construction companies, suppliers, project managers, technical experts etc.). A claim would normally be brought against a contractor and, where it is possible to allege or prove their fault, other participants in a construction process. For its part, a contractor can make a recourse to such other players with contributing fault. Because liability is not strict, it is necessary to prove a

chain of causation between the loss suffered and a defect due to the fault of a contractor and/or wrongdoing of another party.

In the light of the statute of limitations as discussed above, the question arises as to whether the time bars established in days under sub-clause 20.1 (*Contractor's Claims*) of FIDIC contracts will be enforceable in Ukrainian courts. The statute of limitations may be interpreted and applied by local Ukrainian courts as a mandatory rule (irrespective of the law governing a contract), which prevails over contractual deadlines. The existing Ukrainian court practice on the use of FIDIC contracts is not well-developed, and does not suggest a ready answer to many questions, including on the legal effect of contractual time-bars. It cannot be excluded that the Ukrainian courts may take controversial decisions on the matter, as with other cases where the courts have departed from contractual provisions (including in FIDIC contracts) in favour of certain concepts and provisions of Ukrainian law (e.g. a material change of circumstances, an unfair balance of rights, public needs, etc).

The statute of limitations should be distinguished from the guarantee term. Ukrainian law does not provide very detailed guidance on the guarantee term. Regulation No 668 (item 104) establishes a 10-year guarantee term for the use of a construction object, starting from the date of acceptance by an employer, unless a longer guarantee term is established by law or contract. During this term, a contractor should guarantee the quality of completed works and mounted plant, attainment of indicators set out in design documentation, and operational fitness. This can be considered as a replication of what is commonly known as “decennial liability” in other jurisdictions.

Unlike many other jurisdictions, Ukrainian law does not expressly establish a strict (“no default”) liability for construction works during the guarantee term. A contractor is liable for defects or errors revealed in the works performed (a construction object) within the guarantee term, unless it proves that a defect is due to a normal wear or tear, improper use of property or maintenance performed by an employer or its nominated third party contractors, or otherwise for reasons not attributable to a contractor.

When claiming damages, certain peculiarities of the local market should be considered, as these may affect the prospects of the recovery of damages. In Ukraine, there are no compulsory statutory requirements to insure a contractor’s liability for defects during the statute of limitations, or otherwise, but such can be taken out on a voluntary basis. Because insurance increases construction costs, parties often decide to do without. Consequently, it may be problematic to obtain recovery from a contractor where significant costs are at stake and there is no insurance in place.

Furthermore, when contracting with public bodies or state enterprises, it is necessary to account for the fact that all payments that they make, including indemnification of damages, are financed from relevant state or municipal

budgets and, before any payments can be made, they must be included in the annual budget estimates or financial plans of state enterprises, as relevant. Otherwise, it may not be possible to recover damages, whatever the amount and the applicable procedure in a contract. Where there is a valid and effective decision of a court or an arbitration award enforceable in Ukraine, it will serve as the ground for allocating public funds. One should understand and be prepared that a public body or state enterprise will rigorously defend against any claims and will pass the cause through all court instances. Where a contract allows for a range of penalties (for example, delay payments within the certain percentage spread), state bodies will always claim the highest amount to avoid being charged with causing shortfalls to the public budgets. This is due to Article 29 of the Budget Code qualifying proceeds from the imposition of sanctions (penalties or fines) as income of the state budget.

Regarding grounds for relief from liability, FIDIC contracts provide a detailed definition of force majeure and describe its consequences in sub-clause 19.7 (*Release from Performance under the Law*) of the “Red Book” or “Yellow Book”. FIDIC contracts set forth a non-exhaustive list of force majeure events (such as wars, hostilities, rebellion, terrorism, earthquakes or other natural catastrophes, strikes or lockouts other than by contractor’s staff, radiation, etc).

Ukrainian law provides a very general guidance with reference to an accident and insuperable force, which comes closest to the concept of “force majeure” in FIDIC contracts. Article 617 of the Civil Code releases from liability for a breach of an obligation, if caused by an event or circumstance being an accident or insuperable force; the latter is defined in very general terms as an extraordinary or unavoidable event. Ukrainian legislation does not set forth a precise or exhaustive list of such events. Such circumstances are usually understood to include natural disasters (earthquakes, floods, etc), epidemics, and epidemics amongst animals, military action and martial law. Contracts will sometimes mention governmental decisions or other acts of public authorities, and this is open to practical issues and controversies in projects involving permits or other regulatory components, such as construction projects. Under Ukrainian law, no exemption from liability is granted for non-performance of obligations by a debtor’s counterparty, absence of the goods required for performance of the debtor’s obligations in the markets, or shortage of funds.

## **(f) Claim management and dispute resolution**

### **(i) *Litigation vs arbitration***

As in many other jurisdictions, one of the most common causes of construction disputes in Ukraine, including those arising out of FIDIC contracts, is a failure to properly administer contracts and manage claims,

as described above. Local counterparties often disregard the discipline of contract management, and ignore or do not want to face the reality that they may forfeit rights or remedies if they fail to raise or substantiate claims within the time limits established under a contract. Claims are perceived within an antagonistic, rather than a cooperative (as in normal project management) context. Local counterparties are often reluctant to raise claims within the formal procedure of claim administration even when there are grounds. The contractual deadlines for raising or substantiating claims are often missed; this can have an accumulative adverse effect on a project and entail extra costs for one or both parties in having to correct a problem at the later stages of a project. Despite large delays or other substantial breaches, parties tend to suppress problems and not administer claims properly and in due time, for fear of escalation that could result in litigation or arbitration and cause even larger delays or costs (e.g. due to construction suspension, cancellation of a contract and the need to dismiss or replace a contractor) or require retendering and the search for new counterparties willing to take over and complete an unfinished project and assume the associated risks.

As a matter of practice, many local contractors and consultants often have no dedicated contract or claim management departments. This leads to the inefficient management of claims and may cause, for example, delays, omissions. A common pitfall in claim management procedures has been a failure by a party to duly submit either a notice of the claim – or the full details of the claim – in due time; and/or inconsistencies between the notice and the details, either in form or substance.

The prevailing approach in construction projects has been to litigate in the local Ukrainian courts<sup>14</sup> rather than referring disputes to arbitration, although both litigation and arbitration are deemed legal and viable options for dispute resolution in construction disputes. Governmental agencies which will usually opt for litigation. In practice, after some negotiation and drifting between the local courts and arbitration, parties can be seen ending up in blended solutions, and developing disintegrated, ramified dispute resolution clauses in contracts.<sup>15</sup>

For convenience, affordable costs and the territorial proximity to construction projects based in Ukraine, parties often indicate in arbitration

<sup>14</sup> In Ukraine, there are no dedicated construction courts or other bodies specialising in resolving construction disputes; such cases are heard by general civil or commercial courts.

<sup>15</sup> To provide a few examples: in some construction contracts a split was made between legal vs technical matters, and different dispute resolution procedures were set out, dependent on the type of matter. Interestingly, however, no further guidance was provided in these contracts as to how to distinguish between the two types of matter (if, indeed that was possible). A consultancy agreement with an engineer is often governed by a law other than the governing law of a contract for construction works, and different dispute resolution procedures apply, notwithstanding that contracts are closely intertwined in terms of regulation of engineer's performance. Disintegration, creativity and manipulation around dispute resolution provisions is one of the major areas of concern in construction contracts. Should it come to dispute resolution, parties may encounter all sorts of practical complications, and sometimes find themselves in a deadlock.

contracts the International Commercial Arbitration Court of the Chamber of Commerce and Industry of Ukraine as an arbitration provider. Other popular arbitration providers are the Vienna International Arbitral Centre, the Arbitration Institute of the Stockholm Chamber of Commerce, the International Court of Arbitration at the International Chamber of Commerce, and the London Court of International Arbitration.

Ukraine is a party to the 1958 New York Convention “On Recognition and Enforcement of Foreign Arbitral Awards”, and its Law “On the International Commercial Arbitration” is based on the UNCITRAL 1985 Model Law on International Commercial Arbitration. Hence, Ukraine has a proper regulatory framework for the application of international arbitration solutions in construction projects. Construction disputes can be referred to international commercial arbitration (whether in Ukraine or abroad), subject to an arbitration agreement and provided that: (i) the place of business of at least one of parties is located abroad, or (ii) at least one of entities has a foreign investment in it.

Ukrainian counterparties will usually opt for Ukrainian law as the governing law of a contract. However, they may choose any other law of a contract, which would apply to the extent that it does not contradict the mandatory requirements of Ukrainian law or is not incompatible with *ordre public*. It is not always possible to clearly classify legal provisions and differentiate mandatory rules from discretionary provisions of law; this may cause practical difficulties and ambiguities, including for parties to international construction contracts, as discussed above.

Existing Ukrainian court practice on the use of FIDIC contracts is limited and not well-established.<sup>16</sup> One recent case related to a project for the rehabilitation of a public transport infrastructure facility under the FIDIC “Red Book”. The Contractor was responsible for continuing, substantial delays; it also prepaid unauthorised sub-contractors and committed other breaches. The Employer decided to terminate the contract by serving a notice of termination on the contractor under sub-clause 15.2 (*Termination by Employer*) of the “Red Book”, and to request a call on the advance payment guarantee and performance security guarantee. However, the guarantor bank dismissed both requests for the lack of specification and evidence of the breach, invoking the ICC’s Uniform Rules for Demand Guarantees and the provisions of the Civil Code.<sup>17</sup> For its part, the Contractor damages caused by termination of the contract. The claims have not been resolved through the Engineer’s determinations, and the Employer had no funds with which to appoint the DAB, and decided to submit the case to the local court.<sup>18</sup> The owners

<sup>16</sup> For the discussion on some relevant court practice, please see section II(b), (e) and (f).

<sup>17</sup> ICC Publication No 758. FIDIC has also officially endorsed the ICC’s Uniform Rules for Demand Guarantees in 20 The ICC form of the guarantee is referenced in FIDIC contracts.

<sup>18</sup> As of the writing of this article, the case is pending consideration.



of the contractor's company also brought a case against the guarantor before the local court, and the court imposed an injunction prohibiting any payments under the guarantees during the investigation of the case.

The above court case is indicative of certain problems that are encountered in Ukraine by employers in construction projects secured by bank guarantees in the event that local banks are involved which are subject to the jurisdictions (and, consequently, injunction orders) of the Ukrainian courts.

***(ii) Dispute adjudication boards and other alternative dispute resolution methods***

Dispute adjudication boards ("DABs") or equivalent institutes with vested dispute settlement functions are not common in Ukraine and, as a rule, are not used in construction other than in the projects based on FIDIC contracts. Even then, it is often the case that the provisions of the General Conditions of FIDIC contracts on the appointment of DABs (or dispute review boards ("DRBs")) are deleted by operation of the overriding Particular Conditions. The procedures involving DABs or DRBs are viewed by local market players as causing unnecessary delays and adding no practical value, since they are not enforceable under Ukrainian law. In some cases, the provisions on the establishment of DABs survive in FIDIC contracts, but in practice parties often fail to create the standing DABs.

In Case No 9/40/07 under the claim of Municipal Enterprise "Vodokanal" ("employer") to LLC "Trust "Zaporizhbud" ("contractor") regarding the indemnification of damage under the contract for the procurement of works for the reconstruction of the Dnipro Water Supply Station (DVS-1) in the city of Zaporizhia, which was based on the FIDIC's "Red Book". The court did not accept the Employer's reasoning that a DAB awarded the recovery of UAH 250,000 in delay damages to the Employer. The court stated that a DAB's decision is not binding on the court. The court also refused to consider as incontestable evidence the letters issued by the engineer whereby it satisfied the Employer's claims for the recovery of delay damages.

Where a public employer is involved, it will typically insist on deleting contractual clauses concerning a DAB as decisions of a DAB cannot be invoked by a public employer before the controlling authorities as a sufficient ground to substantiate additional public expenditure or undertakings. This is the strong reason for public employers to opt for litigation in the local Ukrainian courts, as previously discussed.

Voluntary participation in professionally organised mediation societies is not, as yet, widespread. Mediation is used rarely, and then limited to certain categories of cases (e.g. family or labour disputes). Mediation has not yet been introduced to large projects with corporate players, such as large construction projects. One of the reasons for the rare use of mediation

is the absence of regulation, and a lack of surrounding culture of its use. In November 2016, the Ukrainian parliament finally passed Draft Law No 2480 “On Mediation” following its first reading; it follows the pattern of the German Mediation Act (*Mediationsgesetz*), adopted in 2012.<sup>19</sup>

### III. CONCLUSION

Ukraine has been progressing with construction sector reform, the core of which is the targeted deregulation and demonopolisation of the market, its opening up to inward investment, and integration in European and global markets. Within this context, an important practical task is to increase the quality and efficiency of construction, including through the introduction of independent and professional supervision and quality control, a greater use of FIDIC contracts, and promotion of the role of consulting engineers. To date, FIDIC contracts (typically, the 1999 “Red Book” or the “Yellow Book”) have been used in Ukraine chiefly in projects funded by IFIs; for other projects, FIDIC’s practices and standards of contract documentation remain mostly unknown and unused.

Recent legislative developments have raised the outlook for both growing the institute of consulting engineers and a broader use of FIDIC contracts and other best practices. In 2017, the governmental decree factored the role of the consulting engineer into the system of quality control and technical supervision of road construction works.

In contract law, the principle of freedom of contract is translated through many dispositive rules of the Civil Code, which are supportive of the use of international forms of contract in Ukraine. Yet, there is a number of restrictive requirements and procedures, set out in different laws, which currently hamper the efficient implementation of FIDIC-based projects, especially where public budgets are involved. The legislative framework should be further liberalised and adapted to meet the needs of international construction projects and improve the efficiency of project and cost management. Significant efforts should be taken to increase awareness and capacity aiming to ensure that FIDIC contracts are properly interpreted and applied by all market players. Promoting the consulting engineering industry and greater use of FIDIC contracts are important directions of the evolving construction sector reform and, at the same time, they will help achieve other strategic objectives within the broader agenda of economic reform in Ukraine, as well as Ukraine’s association with the EU and its role in the integration of international markets.

<sup>19</sup> It is not yet clear when this is to be transposed into law. The promotion of mediation is also featured as a future goal in certain political programmes outlining the future development of Ukraine’s legal system.