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The subcontract within the international construction contracts;

A comparative study

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CONTENTS

MAIN ABBREVIATIONS

Co.	Company
Construction L. Int'l	Construction Law International
Const. L.J.	Construction Law Journal
FIDIC	Fédération internationale des ingénieurs-conseils
ICE	Institution of Civil Engineers
INCOTERMS	International Commercial Terms
JCT	Joint Contracts Tribunal
ICC	International Chamber of Commerce
ICLR	International Construction Law Review
Ltd	Limited
Q&A	Questions & Answers

The subcontract within the international construction contracts; A comparative study

ABSTRACT

This paper examines the subcontract within the framework of international construction contracts.

The main issues to be analyzed are a close link between the main concession contract and subcontract, the law applicable to the subcontract, the right to a direct claim / payment of the subcontractor against the developer as well as the law governing this direct claim.

Furthermore, international standards conventional texts will be identified and the importance of defects in the work will be pointed out, as so will the usual preference of the parties to resolve disputes through the arbitration process.

All the above-mentioned subjects constitute the "structure" of a small study in the private international law issues arising from a subcontract as part of international construction contracts.

Keywords: international construction contracts; 'contracts - satellites'; subcontract; three-partial nature; conflicts of law; Rome I Regulation; right of direct action; subcontractor's liability; 'pay-if-paid' clause; protective laws;

INTRODUCTION

I. Historical Background

By the middle of the 18th century, and almost in parallel to the French Revolution (1798), a major development was initiated in England that transformed the country into the center of modern technology[1]. This development led to the mechanization of production, a phenomenon that was hitherto unknown in history. The mechanization, with successive structural and functional improvements, as well as retroactions and escalations, that actually caused chained newer improvements. In addition to the above, another major impact was the creation of the industrialization, which, in turn, triggered the industrial revolution (First Industrial Revolution, 1780-1810)[2].

The industrial revolution was a particularly complex technical system of economical and social realignment, which transformed the European communities from their agricultural form to a new industrial one. The historians were troubled about this transformation after it had occurred and they found necessary to record the conditions and the developments that lead to the industrial revolution, particularly in England. From a current scope, there did not seem to be important differences between the big and powerful countries of Europe, such as Great Britain, France and Germany. And as far as the technological sector is concerned, this perception is a right one. However, there were differences within the political, economical and social sectors, as at the time, Great Britain was the most powerful of the big forces and perhaps the sole universal force with colonies in every continent. Despite of the fact that up until the middle of the 19th century the main source of income in Great Britain derived from the agricultural sector, the trade was constantly been developed and eventually, alongside the industry, had a primal role to the economic superiority of the country. In the middle of the 17th century Great Britain, the traditional structure of the

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[1] See St. Frangkopoulos, Dr. Mech., Professor at TEI Athens, *History of Technology: Steammotion, Industrial Revolution*, available online, http://sfrang.com/historia/selida500.htm, [in Greek], last visit February 2011

[2] See *Economic History Notes I*, European Economic History (1750-1914), Economic Science Section, Ethnikon kai Kapodistriakon Panepistimion Athinon, available online: http://www.econ.uoa.gr/UA/content/gr/Article.aspx?folder=308&office=16&article=1165, [in Greek], last visit February 2011

large rural property had been modified, a fact that came as a consequence of a "social revolution"[3]. In many cases, the distinguishing lines between social layers were blurred, due to the fact that a variety of traditional obstacles of evolution were pushed aside. As a result, there was vast mobility between professions, leading to the distribution and passing of knowledge and skills. The invention of the locomotive and consecutively of the railway, lead to the movement of population to look for work places to new areas, where work offers flourished because of the factories or the work units that had been built there[4]. This fact led to the need of building new houses in these areas, in order to have these people accommodated.

Over time and in parallel to the development of technology and transportation, more and more people moved out of their home countries' borders, while at the same time, the need for international construction projects became more intense, within this globalization. The professional sector of international constructions caused a great interest, as it involved investments that offered fast economic success[5], with a lot of dangers and of course, with great risk for an opposite result[6]. Evidently and because of the socio-economic conditions, the sector of the international commercial transactions that flourished and developed fast, was that of the international construction projects.

II. International Construction Contracts as International Commercial Transactions

The international commercial transactions are defined as the contract relationships developed between businesses or business parties from different countries that practice transnational economic activities in various sectors, such as the provision of goods, the provision of services, project construction, copyright exploitation and capital transactions.[7] More particularly, as far as the construction sector is concerned, international transactions are being developed within the international construction industry, that is, the construction industry of a country that is exports-oriented and the purchasers of construction services, or construction works,

[3] See St. Frangopoulos, supra note 1
[4] See Reg Thomas BSc (Hons), *Construction Contract Claims*, Second Edition, Palgrave editions, p. 1
[5] See Cushman Robert Frank, Myers James J., *Construction Law Handbook*, Aspen Publishers, Volume 1, Construction Law Library, Wolters Kluwer, Law & Business, 1999, at 34
[6] See Reg Thomas, supra note 4, p. 2
[7] See P. Glavenes, *International Construction Law in* International Transactions Law, Edition Nomiki Vivliothiki, 2010, [in Greek], at 701

that are located at another country, that is, the country of utilization of the construction project.[8]

An important matter of methodology arising from every international commercial transaction, hence, for the international contract of construction, is that of the legal order, that is, the legal order upon the legal matters arising within this kind of activity[9], are based upon and examined in vitro, as the limit in a particular legal order[10] would have even more limited results that do not comply with the nature of such activity. Usually, the international commercial participants do not know each other, since they do not activate within the same (national) market. A common characteristic is that they do not even use the same language of commercial communication. Therefore, a natural result could be the development of uniform process approach and the unified ways of function, which reassure good faith within these transactions.

The international law science developed the theory that apart from the national legal orders and the international legal order, there is a third legal order that controls effectively the international financial relationships within its law-productive, judicial and enforcement mechanisms. This legal order is known as transnational, non-national[11] or, "lex mercatoria", as it has been established. Basically, lex mercatoria is the law of the self-regulation of the national economic activity that bonds (when and if possible) the parties. Of course, the extensive party autonomy acknowledged by many national law applications, does not diminish the national particularities. On the contrary, these particularities are manifested according to the valid law application and the borders of the party autonomy are a matter of delineation of regulatory intervention of the law in relation to the intergrative action of the international construction industy[12]. Besides, in certain countries the construction contract is regulated exclusively by the private law, while in other countries public law is in

[8] ibid., at 702
[9] ibid.
[10] Usually it is the legal order where the work is being constructed and therefore, the contract takes place in
[11] A portion of scholars, the so-called «traditionalists», in contrast with the «transnationalists» question whether there can exsist a non-national reality, see D. Lehmkuhl, *Resolving Transnational Disputes: Commercial Arbitration and the Multiple Providers of Governance Services*, 2003 ECPR Joint Sessions in Edinburgh, March 28 – April 2, Workshop 11: The Governance of Global Issues: Effectiveness, Accountability, and Constitutionalization, at 3
[12] ibid.

charge when one of the parties involved is a country or a public organization[13]. In Greece, the construction contract comes under the authority of the contract law (and is ruled by the Section 681 of the Greek Civil Code (GCC) for the contracts of work), while the contracts with the public sector (when the state or a state-owned corporation participates[14]) are governed by public aministrative law, The Public Works Act, 1418/1984, as amended by Law 2229/94 and Presidential Decree 609/85[15].

The distinction between debtor and creditor is of highly importance for the project construction contract, as it defines the rights of the parties involved due to the overdue breach or the failure to perform. According to the prevailing opinion, the debtor is considered to be the project contractor and creditor the owner of the project, as the required co-operation of the owner of the project during the project execution does not constitute a genuine, indepedent obligation and, therefore, it doesn't constitute a debtor's obligation.

III. International Construction Contract, or more accurately Contracts; A main contract as the «prime celestial body» & «contracts – satellites»

The international construction activity is a transnational commercial transaction with certain particularities. Due to the nature of this transaction, there is an undoubted close connection with the territory of the country where the project takes place, resulting to an intense invention character. It is rather an invest activity than a simple commercial transaction, as the contractor comes to face increased dangers to the country of reception, the country of project execution[16]. In a more simple form, the international construction project contract is a project contract between a foreigner contractor and a project owner of the country of the project installation, with which project contract the contractor is appointed to execute the construction process of the project upon the project owner[17].

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[13] See E. N. Moustaira, Kinodikion 2000, *Construction Contract: Comparative Study of Rights and Issues of Private International Law*, [in Greek], at 313

[14] ibid., at 314

[15] The Greek Civil Code applies for these works, too. However, if there is a conflict between the GCC provisions and the Public Works Act, then usualy the second one prevails and applies, see V. Katsantonis, S. Georgiades, J.B. Tieder Jr, *An Overview Of Construction Contracting Under Greek Law*, available online http://www.georgiades.com/publications/georgiades3.doc, (last visit in February 2011), at 4

[16] See P. Glavenes, supra note 7, at 706

[17] ibid., at 707

However, there is not a uniform prototype of international project construction contract, due to the variety of services that constitute the object of application. Besides, the international project construction contract could be tested differently to the rest of the contracts that constitute the same construction project[18]. Therefore, the term "project construction contracts" is more accurate to its plural form, as it has to do with a conventional agreegation truly interdepedent. The main contract between the project contractor and the project owner becomes a contract acting as the «main celestial body» surrounded by «contracts - satellites» who refer to a particular activity or specification of the intervening party[19]. The subconstruction contract is complied within this umbrella.

[18] It's characteristic that in Switzerland the construction contract is regarded as a mixed contract (combined of contract of work and contract of service), see M. Scherer and M.E. Schneider, *International Construction Contracts under Swiss Law: an introduction*, (2007) 23 Const. L.J. No8, at 561

[19] See E. N. Moustaira, Kinodikion 2000, supra note 13, at 328

PART ONE

CHAPTER A

I. Subconstruction Contract; Definition

There is no definition of subconstruction, either within the English law, or within the Directive 2000/35/EC on combating late payment in commercial transactions, or even within the German, Belgian or Spanish law that protects sub-contractors[20]. The definitions of the project construction contracts for the subcontractors do not always define the subcontractor, but they are broader definitions, that include even the simple providers of materials or machine lettings, that are however related to the contractor with another kind of contract (e.g. with a sale or letting contract) [21].

Anyhow, the term "subcontractor" even by definition ("sub" and "contractor") shows that it should be defined by the conventional relationship between third parties or entities. So, a definition of the subcontractor contact could be the following: "Party or entity that has been appointed the construction of a project (with conventional obligation towards the owner of the project) appoints a third party to perform, according to instructions given, the execution of a part / parts of the project[22]".

As clearly pointed by the above-mentioned definition for the subconstruction contract, a crucial point of the definition is the three-partial nature of the relationship, as the contract that the subcontractor attaches has as a starting point another, pre-existing contract, but without an existing conventional relationship between the project owner and the subcontractor.

The fact of the non-existence of the conventional relationship between the project owner and the subcontractor offers autonomy to the subconstruction contract, which is empowered by the phenomenon of expertise. As it is usually the case in complex projects, the expertise subcontractor can propose the previously signed convention of exclusivity. The autonomy of the subconstruction contract in itself and

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[20] See J. F. Pulkowski, *The Subcontractor's direct claim in international business law*, International Construction Law Review 2004, at 33

[21] See P. Glavenes, supra note 7, at 763-764

[22] See E. N. Moustaira, Kinodikion 2000, supra note 13, p. 332; See also J. F. Pulkowski, supra note 20, p. 33 and Paola Pirodi, *Yearbook of Private International Law*, Vol.VII, 2005, edited by P. Sarcevic, P. Volken, A. Bonomi, Sellier European Law Publishers, 2006, at 290

the three-partial relationship between the owner of the project, the contractor and the subcontractor, have as a consequence that the contractor is set responsible for the mistakes of the subcontractor towards the owner of the project. [23]

At a first place, if the applicable law of the main contract is silent, then it should be accepted that the subconstruction is permitted[24]. Of course, it is common that the terms of the subconstruction contract refer to the terms of the (main) master contract, as far as the execution of the project appointed to the subcontractor. This is the case, as the contractor whishes to commit the subcontractor in a way similar to the one the contractor has been committed towards the owner of the project (except, perhaps, the price of sub-construction)[25]. So, the subconstruction contract is distinguished to transparent and non-transparent one[26].

II. Transparent & Non-transparent subconstruction contract

In a transparent sub-construction project contract, the terms of the master contract that relate to the part/sector of the project that has been appointed to the subcontractor to execute, are transferred self-same to the subconstruction contract. Consequently, within the transparent sub-construction contract, all the terms of the master contract that relate to the subcontractor, are turned to terms of the contract between the contractor and the subcontractor.

In a non-transparent subconstruction project contract, the contractor, as another master of the project, appoints the subcontractor a particular project, with special terms, completely independent to the master contract. In this way, the terms and conditions of the master contract execution are completely differentiated to the terms and conditions of the subcontractor project contract. Of course, in practice a subcontractor project contract is not only transparent or only non-transparent, as there

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[23] Specifically for Belgium and Germany see Belgium Schoups, Van Bosstraeten & C° Law Firm, Construction and Projects 2010/11, Country Q&ABelgium, PLCCROSS-BORDER HANDBOOKS www.practicallaw.com/constructionhandbook 9, www.practicallaw.com/3-502-2255, pp. 12-13, question 17 and Germany Oliver Moufang, Stefan Koser, Manteo Eisenlohr, Uwe Pirl, Lorenz Claussen, Martin Bünning and Oliver Koos GSK Stockmann + Kollegen, Construction and Projects 2010/11, Country Q&A Germany, PLCCROSS-BORDER HANDBOOKS www.practicallaw.com/constructionhandbook 65, at 69, question 17

[24] See E. N. Moustaira, Kinodikion 2000, supra note 13, at 332

[25] This bond is known as a "**back to back agreement**", see Dr J. Zons, *The Minefield of Back-to-Back Subcontracts Part 2*, Construction Law International, June 2010, at 21

[26] See P. Glavenes, supra note 7, at 764

are many escalations[27] within the connection of the terms of the master contract and the subcontractor project contract.

It should be noted an opinion that argues that the supply contracts, the contracts of construction equipment, the contracts of service and field operations are «quasi-subconstruction» contracts[28].

Furthermore, in order to clarify the definition of the subcontractor project contract, it would be useful to have a juxtaposition of the subcontractor project contract and the assignment contract. The potentiality of the assignment of the master construction contract has of a particular importance when the project takes place in a particular country, where only the companies based in that particular country can be appointed to the construction of the project[29]. The usual practice is to for the master contract, between the owner of the project and the contractor, to predict the establishment of a subsidiary company in that country and the assignment of the project construction contract to that subsidiary.

However, as mentioned above, within the sub-construction contract, there is no conventional relationship between the subcontractor and the owner of the project and this is the basic difference between the subcontractor project contract and the assignment contract. Within the assignment contract, the assignee becomes a direct counterparty to the other contracting party. This fact constitutes the advantage that comes with the assignment, as opposed to the subcontractor project contract, as it concentrates all works involved. A more particular case of an assignment contract is the assignment of the country that is the owner of the project, to one of its services. In such a case, if there exists a breach by the assignee to the conventional obligations, then the country would have to quit its sovereign state immunity (extraterritotoriality)[30].

The subcontractor contract should also be distinguished by the supply contract[31]. The term “subforitura” that exists for subcontractors in Italian Act No192 is a much broader one, resulting to include not only subcontractors, but supply contracts, as well. In parallel, the French court Cour de Cassation ruled in 2002 case No 5133, *Ste Entrepose Echafaudages v. SCI du carillon de Nanterre*, that the

[27] ibid.
[28] See E. N. Moustaira, Kinodikion 2000, supra note 13, at 332
[29] ibid., at 333
[30] ibid.
[31] See J. F. Pulkowski, supra note 20, at 33

obligations included in a subcontractor project contract according to the French law about Subcontractors Law 75-1334, should not only be restricted to the supply contract[32]. A condition of the supply contract is also the existence of a three-partied relationship between the supplier, the businessman and the client. However, the difference to the subcontractor contract is that the supplier does not execute a pre-existing obligation of the businessman.

Another point with a particular interest as far as the definition of the subcontractor contract is concerned, is the question as to when a subcontractor contract is international, as in most cases the subcontractor is based in the same country as the contractor is based in. And this is a question with practical consequences, as according to the answer, it could be determined the payment of the price in foreign currency or the inclusion of the subconstruction contract to a foreign law, the law governing the master constract[33]. It is claimed that if the subcontractor contract is judged based on financial criteria, as a contract that serves the international commerce and is concluded for the execution of another international agreement, then its international character should be recognized. This fact constitutes one of the particularities of the subcontractor contract, as it one doesn't examine it, as usual, if a contracting party is foreign or if the execution of the project includes more than one country but one examines it as one contract that constitutes part of a wider financial transaction - as part of the master contract. Within this frame, rulings of the French courts are limited to the international character of the master contract, in order to characterize a subcontractor contact as an international one.[34]

CHAPTER B

I. Subcontractor/s appointment. The 'intuitu personae' character of the construction contract.

After the appointment of the master contract, the arrangement of one or more subcontractor contracts with subcontractors that have not been proposed, during the

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[32] ibid.
[33] See P. Glavenes, supra note 7, at 763
[34] Judgement ICC N° 7528, Yearbook Comm. Arb'n XXII, 125, 130 (1997), The Franco-British Lawyers Society in collaboration with The Society Of Construction Law, *Overview Of The Protection Of Subcontractors Under French Law*, Maître Carole Malinvaud Avocat Associé Gide Loyrette Nouel, Paris, Tuesday, 5th September 2006 at 6 pm at The National Liberal Club Whitehall Place, London SW1, at 8

pre-contract phase, by the contractor is subject to the clause of the agreement by the owner of the project[35]. This happens due to the character "intuitu personae" of the construction contract[36]. The owner of the project entrusts the contractor with the 'face' of his own business and appoints him with the execution of the project[37], based on professional and financial criteria[38]. This is the reason why it is usually forbidden to appoint the execution, through subcontractors, of all parts of the project that has been appointed to the contractor, by the owner of the project[39]. As a matter of fact, the incompliance of this obligation constitutes a reason of breach of the master contract.

Therefore, the main party to appoint the subcontractor(s), is the contractor, empowered by the master contract that he has undertaken upon the owner of the project. In special circumstances of subcontractor contracts, the subcontractor could be appointed by a consortium of construction companies [40], or by the owner of the project (nominated subcontractor)[4142] or by the project manager (who then becomes the main contractor[43]) or by a concession company (in the case of financed large scale projects)[44].

A special case for the international construction contracts is the "imposed subconstruction"**,** that is the subconstruction that is imposed to the contractor by the owner of the project. In the case of imposed subconstruction, the owner of the project indicates to the contractor one or more subcontractors that come from the country where the project is located (designated subcontractors), to whom the contractor is obliged to appoint the execution of the project he has undertaken, composing one or

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[35] See P. Glavenes, supra note 7, at 763

[36] See E. N. Moustaira, Kinodikion, Editions Ant. Sakkoula, Athens 2002, *Book Review,* Roger Philippe Budin, Guide pratique de l' execution des contrats internationaux de construction (Staempfli Editions SA Berne 1998), pp. XIX+298, at 159

[37] According to Swiss law (article 364(2) of the Swiss Civil Code), the subconstruction contract is the exception; It should be noted that the Swiss law is a law many times chosen by the parties considering it to be a «neutral» law, see M. Scherer and M. E. Schneider, *International Construction Contracts under Swiss Law: an introduction*, (2007) 23 Const. L.J. No8, at 563

[38] As Elina N. Moustaira argues a small subcontractor's bankruptcy could resuly in chain reactions, and for this reason subcontract is regarded as the «Achilles' heel» in the contstruction process, see E. N. Moustaira, Kinodikion 2000, supra note 13, at 333

[39] In China the subcontractors are forbidden to appoint further subconstruction contracts of their works to other subcontractors, see E. N. Moustaira, Kinodikion 2000, supra note 13, at 320

[40] See P. Glavenes, supra note 7, at 759

[41] See E. N. Moustaira, Kinodikion 2000, supra note 13, at 332

[42] The owner of the project holds a claim against the subcontractor only if provided by an express provision, otherwise the autonomy characterizing the main contract in relation to the subcontract remains untouched ("transparency", "If and When" clause), ibid., at 332, footnote 30

[43] ibid., at 331

[44] See P. Glavenes, supra note 7, at 738

more subconstruction contracts with them[45]. The indication of such an obligation occurs, apart from the obvious reason of empowereing the local workers, for the evasion of payment in foreign currency, too and it is an obligation that could result to hinrance and in some cases, to irreparable losses for the foreign business[46]. This indication could also result to the problem of inadequate quality service by the designated subcontractors, delays, disagreements with the engineer or the contractor, refusal to repair mistakes without any additional payment, pressure towards receiving payment in advance of the undue or additional prices (in many cases, threatening to abandon the works), insolvency proceedings[47].

Every law order presents differences as to whom it is allowed to appoint a project to subcontractors and to whom it is not. For instance, in Japan, the owner of the project cannot appoint a subcontractor, while, in the same country, within the private construction companies contracts, another contractor, a third party, guarantees to execute and complete the project, following the initial contracting party, in the case of incompletion[48].

Furthermore, in Japan, the big construction companies do not allocate immediately employees or constructing equipment and in order to complete the project, they undertake conventionally towards the owner of the project to have contracts of subcontruction with other construction companies. These subconstructions are appointed to subcontractors upon negotiation for a number of years. An interesting fact is that the contractor usually provides the subcontractors with the necessary materials and construction equipment, but because the contractors do not own them, as mentioned above, they engage them from companies that hire relevant equipment. Within this frame, the basic duties of the contractor are the checking of the quality, the schedule, the security and the cost of the project[49].

II. When does the assignment of the subcontractor(s) take place

The appointment of the execution of the project to subcontractors can take place before the master construction contract, with the clause of the signment of a construction contract. The appointment of the project execution can also take place

[45] ibid., at 763
[46] See E. N. Moustaira, *Book Review*, supra note 36, at 154
[47] ibid., at 155
[48] See E. N. Moustaira, *Kinodikion 2000*, supra note 13, at 319
[49] ibid.

after the master construction contract, if the subcontractor is mentioned in the quatation of the constractor to the owner of the project.

III. The subcontractor's obligations and his liability towards the main contractor

Upon completion of the subconstrion contract, the obligation of the subcontractor towards the master contractor is a triple one, as it is a guarantee for[50]:

1. The quality of provisions, the works and services offered
2. The respect of the execution deadline
3. The respect of the agreed price.

The subcontractor is liable towards the master contractor, in the way a contractor is[51]. As mentioned above, the master contractor is responsible for transmitting to the subcontractors the entire range of responsibilities towards the owner of the project and many times with the most austere manner. If the subcontractor breaches the conventional duties towards the contractor, does not involve an immediate matter of responsibility of the contractor towards the owner of the project, to the point where the two contracts (subconstruction contract and master contract) are autonomous. Of course, usually in practice, any infringement of the subcontractor has consequences to the master contract that connects the contractor to the owner of the project. In the same way, the subconstruction contract is affected in case of a charge or end to the master contract, especially if it is a case of transparent subconstruction[52].

CHAPTER C

I. The importance of subcontracting in international commercial law

There is a significant importance of the subconstruction within the current trends of the international commerce law. The big construction companies undertake very large projects, public or private ones and in order to correspond to the the conventional responsibilities, many times they have to rely on other businesses, with technical expertise in certain areas, either for reasons that relate to the expertise of

[50] See E. N. Moustaira, *Kinodikion 2000*, supra note 13, at 332
[51] See P. Glavenes, supra note 7, at 765
[52] ibid.

these companies, or for financial and practical reasons[53]. So, it is very common for a subcontractor, or subconractors, to perform the duties of the contractor and in most cases they are small businesses, though this is not necessary. The fact, that the projects are run within multiple markets, outside the narrow borders of a particular territory, had as a consequence for the construction companies to operate not based on one contract, but multiple (interdepending) contracts. Of course, the valid commercial laws and the legislations within the European Union that predict the protection of the commercial transactions, have lead to the increasing appointment to subcontractors from "low budget" countries, as the rules of immediate application rarely protect the subcontractors[54].

II. Protection of the subcontractors under various national laws

The subcontractors depend financially directly on the contractors[55]. Besides, the continuous and long co-operation practice between contractors and subcontractors, on one hand offers the opportunity to subcontractors to have work on a permanent basis, but on the other hand it includes serious dangers due to the financial dependence that connects them together. As a result, in case the contractor faces insolvency proceedings, he also sweeps along the subcontractors, who very often also enter into an insolvency proceeding[56]. The subcontractors are usually companies of small or medium size that contract with big construction companies. Therefore, they do not have the required accounting or the legal knowledge in order to enter to complex contracts of great financial interest. For this reason, they usually are in an inferior position, being manipulated by the powerful "players" of the contract. The result is that they constitute the weakest ring of the chain of construction contracts.

These reasons lead to the need of the protection of subcontractors towards the unfair contract terms. It was Japan first to recognize this need, in 1956 and proceeded to a legislative regulation of the matter by the June 1st 1956 Act against delay in Payment of Subcontract Proceeds, etc. to Subcontractors No 120, in order to guarantee adequate payment of subcontractors[57].

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[53] See J. F. Pulkowski, supra note 20, at 31
[54] ibid., at 32
[55] ibid.
[56] The German corporation Holzmann Ag is a characteristic example, as it caused the bankruptcy of hundreds of subcontractors, see New York Times, *Big Builder In Germany Is Bankrupt*, Mar 22, 2002
[57] See J. F. Pulkowski, supra note 20, at 32

Italy and France proceeded to coding rules, Italy by the "Law of 18 June No 192" and France by the Law 75-1334 /1975[58].

England, Whales and Scotland predicted the protection by the articles 110-113 of the "Law Housing Grants, Construction & Regeneration Act 1996", North Ireland proceeded to the establishment of "The Construction Contracts Order 1997", Portugal predicted by the articles 1213 and 1226 of the Portugesse Civil Code, Spain with the article 1597 of the Spanish Civil Code, Belgium with the article 1798 of the Belgian Civil Code and Germany with the article 641 point 2 of the German Civil Code

The European Union published the Directive 2000/35/EC[59] in order to fight late payments in commercial transactions, which includes protection points for subcontractors. Particularly, at point 7 of the Preamble the Directive emphasizes that small and medium- sized companies take on the heavy weight of the financial transactions, as a result of the extensive periods of payment and delays of payment. As a matter of fact, this financial weight is also the greater factor leading to bankruptcy, threatening the actual existence of these businesses. Below, at point 19 of the Preamble, if the contractor imposes to the subcontractors unfavourable payment terms, that he is not justified to impose based on the master contract with the owner of the project, it is fixed as abuse. At point 22 of the Preamble, it is predicted that the Guide is valid for private as well as for public contracts and that the Guide regulates all commercial transactions between the master contractors and their providers and their subcontractors[60].

The legislation of some countries predicts the recording of the "legal mortgage" by the contractor to a property of the owner of the project when the agreed fee is not paid. The subcontractors also have this ability. The result is that, even if the owner of the project has paid the master contractor, if the latter has not paid the subcontractors, then they have the right to ask the responsible judge the permission of registrating a mortgage upon the property of the owner of the project. The registration of such a mortgage can have as a consequencethe cancellation of the credit for the construction, a fact that would cause a great loss to the owner of the project. So, if

[58] See Law On Subcontracting (n°75-1334), with the participation of Louis VOGEL, Professor at the University of Paris II, discussion and adoption of 20 December 1975

[59] Greece is adopting its legislation to Directive 2000/35/EC by the Presidential Decree 166/2003, βλ. website Lawnet, LawNews Center, Greece, *In 30 days the payments by the Greek Public*, 11/2/2010 9:59:50 am

[60] See Directive 2000/35/EC of the European Parliament and of the Council of 29 June 2000 on combating late payment in commercial transactions

there exists such legislation in the country of execution of the project, this danger for the project could be avoided by the continuous supervision of the subcontractor payments by the basic businessman or by the engineer himself, if a relevant clause predicts this kind of duties for the engineer. Anyhow, the fundamental valid rule is that the terms of the subconstruction contract would be identical to those of the master contract, as far as the execution of the works appointed to the subcontractor are concerned, within the transparent subconstruction.

Some of the protective legislative predictions (the French Law 75-1334 /1975, Spain with the article 1597 of the Spanish Civil Code and Belgium with the article 1798 of the Belgian Civil Code) offer to the subcontractor the right to demand compensation / payment for the work performed, directly by the owner of the project. The establishment of this right of direct claim of payment by the owner of the project[61] (right of direct action) protects the subcontractors by the greater danger they face: the bankruptcy of the main contractor[62]. But, if some of the third parties (or entities) of the three-partied relationship that connects the master contract with the subcontractor contract is basd in a different country than the rest, then the question is what kind of law decides on the existence or the borders of the direct claim of the subcontractor towards the owner of the project.

That is why, before examining this right, it is useful to analyze the applicable law in an international construction contract first and then in a subconstruction contract.

III. Applicable law of international construction contract

A. Private Projects

In the case of a mere private contract within the international construction contracts, the issues of the private international law are relatively simple and the traditional method of finding out the applicable law is applied[63]. So, applicable law could be either the law chosen by the parties for a part of their contract, or even more, in cases where the settings of the contract are very detailed, applicable law could be the contract itself (self regulatory contract). Having Greece as forum, the Rome I Regulation is applied to contracts between the countries where the Regulation is

[61] See infra, Part II
[62] See J. F. Pulkowski, supra note 20, at 32-33
[63] See E. N. Moustaira, Kinodikion 2000, supra note 13, at 321

valid[64]. For contracts that were constructed prior to the enforcement of the Rome I Regulation (before December 17, 2009) the application is either the Rome Convention of 1980, or the rules of Greece's private international law (article 25 GCC) for contracts that were constructed prior to the ratification of the Rome Convention (1.4.1991).

The articles 3 and 4 of the Rome I Regulation, are of particular interest. The article 3 paragraph 1 provides the freedom of choice of law, establishing that: "*A contract shall be governed by the law chosen by the parties. The choice shall be made expressly or clearly demonstrated by the terms of the contract or the circumstances of the case. By their choice the parties can select the law applicable to the whole or to part only of the contract*". Therefore, the article 3, paragraph 1 establishes the freedom of choice for the applicable law for the whole contract, or only for a part of it (decepage).

The article 4, paragraph 1, element b of the Rome Regulation I, establishes as applicable law within a contract of provided services, the law of the country in which the service provider has his habitual residence. According to this article, for the services provided by a construction company, the applicable law is that of the country where the contractor's business is headquartered.

The article 4, paragraph 2 establishes that if the contract is not covered by paragraph 1, or if the elements of the contract are covered by more than one of the elements a-g of paragraph 1, then the contract is conditioned by the law of the country in which the party fulfilling the characteristic service (*characteristic performance*) of the contract is located. So, the applicable law within a construction contract is that if the country of the contractor's habitual residence, as the party fulfilling the characteristic performance.

The article 4, paragraph 3 establishes that when the total of circumstances of the case result to the contract being obviously and *manifestly* connected to a country other than the one mentioned by paragraphs 1 or 2, the applicable law is the one of that other country. In the case of an international construction contract, this is the law of the country – location of the project executed.

[64] It should be noted that Great Britain, using the right opt in, accepted and enforced the Rome I Regulation; Rome I Regulation is in force since the 17th December 2009 to all contracts made after that date to all member states, excluding Denmark

Of course, in practice, the prevailing law in most international construction contracts is the law of the location of the project executed.

Lex fori judges the possibility of the choice of the applicable law, while lex causae (lex contractus) judges the possibility of the choice of the applicable law validity[65].

Another important article is also article 9 of the Rome Regulation I regarding the *overriding mandatory provisions* that are applied independently to the applicable law. For instance, these are the local construction terms that impose the existence of the construction permit, the preservation of hygiene and security and often they set the responsibility of the contractor, too. Even more, the provisions of the social security law, such as paid vacations and redundancy compensation, but also customs, tax or currency settings can be part of the overriding mandatory rules.

B. Public Projects

Contrary to private projects, the conditioned problems of the applicable law of public projects are quite complex and for this reason the conditions of the applicable law in international obligation contracts is judged by the case law and by theory as one of the most complex sectors of private international law[66].

In case of an explicit choice of law by the parties, in practice there is also a particularly multifarious "scale of choice of law", as clauses have been contracted, referring to:

- Law of the country that is a contracting party
- Law of the place of location of the private businessman
- Law of a third country
- Two different systems of law
- A state law and to the "principle of good will and good faith"
- Public international law, explicitly or silently
- Principles of law common in national law systems of the contracting parties or in more law systems[67]

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[65] See E. N. Moustaira, Kinodikion 2000, supra note 13, at 322

[66] ibid., at 321

[67] See Channel Tunnel contract which provided as applicable law principles common both to the English and French law, and in absence of such common principles the general principles of international trade law as have been applied by national and international tribunals, see P. Glavenes, supra note 7, at 708, footnote 16; It should be noted though that this contract was conducted before the enforcement of the Rome I Regulation and the clear and express statement of the Regulation to the

- Principles of law recognized by the civilized countries
- Exclusively the contract itself, potentially in good faith, too
- Fundamental principles of law or a combination of such principles that dominate in a particular law category.

In practice, it is doubted as to what extend the contracting parties can decide that their contract will be conditioned by a non state law, for instance as the public international law, the general principles of law or lex mercatoria[68]. Within contracts where one of the parties is the state or a state business, a non-state law can be chosen as the applicable law, but the overriding mandatory provisions of the law of the project execution country will be applied in any case[69].

III. Applicable law in the nexus of construction contracts. Is it one law applicable, which therefore applies to the subcontract,- or are there different laws each one applicable to each one construction contract?

As mentioned above, a series of contracts is composed beyond the main, main contract, between the contractor and the owner of the project. The question arising from the side of the private international law is what law will be applicable in case of a non- explicit choice of law between the parties[70]. From one point of view, the law of the main contract should be applicable to the rest of the contracts, too, for flexibility reasons and for facilitation of the manipulation of any resulting matters. By choosing the law of the main contract to be the applicable one, the possibility of choosing contradicting law solutions is avoided and furthermore, the procedure of recovering solutions becomes simpler. However, from another point of view, the law of the main contract cannot be applicable to the rest of the contracts, as they are very different ones and as a matter of fact, everyone with a differentiating context. Many of the contracts are not connected directly to the construction project, but they are in reference to other objectives, such as employment contracts, contracts of mandate (for training and managing agreements that are included in the main contract) or sale contracts (for instruments that are not closely connected to the project). By adopting

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need of choice of the (one) applicable law; If drafting a similar clause nowadays the UNIDROIT Principles should be preferable, see P.R.H.Christie, *The law governing the construction contract*, ICLR 2007, at 350

[68] See E. N. Moustaira, Kinodikion 2000, supra note 13, at 323

[69] Regarding contracts between private parties there is no need to refer to a non-state law, since the parties can choose a neutral law

[70] See E. N. Moustaira, Kinodikion 2000, supra note 13, at 334

the second point of view, the difficulty of solving matters is definitely increased, but it is certainly a much more realistic point of view.

More particularly and as far as the subcontractor contract is concerned[71], if there are any references to the context of the subcontractor contract in the main contract, then consideration could be made that, according to the article 3 paragraph 1 of the Rome Regulation I, clearly concludes to the law of the main contract. For instance, clear references to the context of the main contract or technical specifications that are also included in the main contract, constitute elements according to which clearly concludes that the applicable law is that of the main contract.

If there is no choice of law, then according to the Rome I Regulation and following the article 4, paragraph 1, element b of the Regulation and the article 4, paragraph 2, the applicable law is the one of the country where the subcontractor has his habitual residence, since the subcontractor is the service provider and in accordance, the place where he has to achieve the characteristic service provision (*characteristic performance*) of the contract. However, according to the article 4, paragraph 3, if from the total of the case circumstances results that the contract is obviously and manifestly closely connected to another country than the one referred to in paragraphs 1 or 2, applicable law is the one of that other country. The question is that if the financial interdependence of the subcontractor contract and the main contract, leads to the law of the principle contract, that is, if because of the existing interdependence "*manifestly"* results that the contract is connected closely to the law of the main contract.

V. Is the accessory determination of the aplicable law of the subcontract depending on the applicable law of the main contract appropiate?

A positive answer to the question above has the importance advantage that one and only one law is applicable to the subcontractor contract and the main contract, resulting to harmonization to court judgements[72]. Furthermore, there is no differentiation to the claims recognized by the parties in both contracts[73]. This way,

[71] See J. F. Pulkowski, supra note 20, at 34
[72] Professor R. H. Christie argues that the main contract and the subcontract are so closely connected that it would be fair almost always the same law to be chosen for both contracts, see P.R.H.Christie, supra note 67, at 351
[73] See J. F. Pulkowski, supra note 20, at 35

the complex nature of the international construction contracts is avoided and the process becomes simpler, having the financial interdependence as the only basis.

However, many disadvantages result from the choice of one only one law. The most important of which is that in this way, the autonomy characterizing the subcontractor contract in relation to the main contract is ignored. The choice of the main contract law basically brings down the segregation between contracts and deprives the subcontractor contract to be autonomous. A second disadvantage is that usually the owner of the project is in an advantageous position and he himself decides on the applicable law, based on his interests. So, usually the valid law on the main contract is the law of the country in which the owner of the project is located – a law with which the main contractor has no close connections. This means that if we accept the accessory determination, the dependence of the subcontractor contract on the main contract, then the subcontractor will be conditioned for his work by a law that not only was he not aware of and was imposed to by the "powerful" party of the agreement, but also it is the law of a country with which he himself does (usually) have few connections. But, the strongest counterargument in a accessory determination / identification of the two contracts is that usually the subcontractor is not aware of the main contract context and consequently, of the applicable law on it. Hence, he does not even have the opportunity to be aware of and predict the applicable on his contract.

From all the above mentioned, results that the interpretation of the article 4 paragraph 3 of the Rome I Regulation, should not essentially guide us to the law of the main contract[74].

Deductively, if there are any terms to the context of the subcontractor contract that refer to the context of the main contract, then according to the article 3, paragrapgh 1 of the Rome I Regulation, clearly results that the law of the main contract has been chosen. If there is no choice of law, then the article 4, paragraph 1, element b and article 4, paragraph 2 are enforced, resulting to the law of the country of the subcontractor location to be the applicable law. The close financial connection between the main contract and the subcontractor contract does not constitute a per se

[74] ibid., at 36

factor that shows that the subcontractor contract is "manifestly" connected to the law of another country, that is, to the law of the main contract[75].

Consequently, in order to move on to the matter of the subcontractor's right to direct payment by the owner of the project, it would be useful to know that the applicable law in the subcontractor contract **could be**, though not necessarily, the law of the main contract[76].

[75] The judgement of The Scottish Inner House First Division, of the 12 July of 2002, *Caledonian Subsea Ltd v. Micoperi Srl* is characteristic as the court denied the accessory determination between a subcontract and a sub-subcontract. The court ruled that the applicable law of the subcontract is only one of the factors to decide the applicable law of a sub-subcontract in the case of absence of choice of law, ibid., at 35, footnote 25

[76] ibid., at 36

PART B'

The right of direct action / claim against the owner of the project

The biggest danger that the subcontractor faces is the bankruptcy of the main contractor. The arising matter is that due to the fact of the autonomous character of the subcontractor contract and so, of the unconventional relationship of the owner of the project and the subcontractor, how could the subcontractor claim payment for his work.

Some national legal orders, for instance, give the subcontractor the right to claim payment or the work he has performed, with the law basis of the unjust enrichment[77]. More particularly:

A. France, articles 3 & 12 of Law 75-1334[78]

According to article 3 of the Law 75-1334[79], a condition for the validation of the direct action right by the subcontractor, is for the owner of the project to approve of the subcontractor and the terms of the subcontractor contract that refer to the payment. In addition to this, according to article 12 of the same law, a previous document of payment claim should have been made by the subcontractor towards the contractor, without the contractor's response. As a result, the subcontractor's right is valid only in case the obligation of the main contractor has not been achieved and only if the subcontractor contract is valid. If the subcontractor contract is not valid, then according to the French law, it cannot be decided if the contractor is due payment. The French law has three levels to the subcontractor's direct payment action right. Firstly, it is valid only for payment included in the subcontractor contract[80]. Second, the owner of the project should have profited by the subcontractor's work, for which the latter claims payment. And third, it is limited to the amount that the owner of the project owes the contractor, on the day of the payment claim by the

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[77] ibid.

[78] See Law On Subcontracting (n°75-1334), with the participation of Louis VOGEL, Professor at the University of Paris II, discussion and adoption of 20 December 1975.

[79] The French court, Cour de Cassation, ruled that this Law is "ordre publique" and, therefore, its enforcement cannot be denied by the choice of a law governing the contract which doesn't recognize such a right to the subcontractor, see Claus Lenz, *Withholding payments due to subcontractor disputes*, No. 3 Construction L. Int'l 35, at 36

[80] See J. F. Pulkowski, supra note 20, at 38

subcontractor to the contractor, according to the document receipt. It is noteworthy that is claimed that this particular law is of obligatory application, even if the majority of the theory judges that something like this is valid only for national French differences and it is not valid in international differences as obligatory applicable law of the French law system[81].

A particularly important fact is that the subcontractor could have contracted further sub-construction with a fourth party or even more. Then, they in turn, have the same right of direct payment claim by the owner of the project and according to article 3 of the French Law 75-1334, the owner of the project should have also approved the ways of payment of the sub-sub-construction.

B. Arabic Civil Codes

Some Arabic Civil Codes also recognize the subcontractor's direct action / claim right[82]. This takes place in the following countries: Algeria with article 565 of the Algerian Civil Code, Egypt with article 662 of the Egyptian Civil Code[83], Syria with article 628 of the Syrian Civil Code, Iraq with article 882 of the Iraqi Civil Code, Kuwait with article 682 of the Kuwaiti Civil Code, Libya with article 661 of the Libyan Civil Code. In most of the above-mentioned countries, the subcontractor's right is of direct application as an overriding mandatory provision and in order for it not to be valid, it should be predicted and clearly agreed in the contract.

C. Spain; Article 1597 of the Spanish Civil Code

According to article 1597 of the Spanish Civil Code and opposed to the French law 75-1334, the owner of the project's approval of the subcontractor is not a condition of validation of the direct action / claim of the subcontractor[84].

The right of the subcontractor is extended however to the amount that the owner of the project owes to the contractor on the day of the payment re-

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[81] See J.-G. Betto, *International Arbitration Awards Digest*, International Business Law Journal 2001, at 649

[82] See C. R. Seppala, *The new Fidic international civil engineering subcontract*, International Construction Law Review 1995, at 12, footnote 17

[83] In Egypt, as well as in France, in any case the owner of the project is liable up to the amount he is due to the subcontractor at the day of the written notice of a payment claim of the subcontractor towards to the contractor, see C. Lenz, *Withholding payments due to subcontractor disputes*, No. 3 Construction L. Int'l 35, at 35

[84] See J. F. Pulkowski, supra note 20, at 38

establishment by the owner of the project[85]. It is not required, as it is in the French law, to have a preceding claim and its non-payment by the main contractor, but the owner of the project should have profited by the work performed by the subcontractor, for which the subcontractor can claim payment. Article 1597 of the Spanish Civil Code constitutes an exemption to the obligation relationship of the contract conditioned by article 1257 of the same Civil Code and constitutes a rule of equity[86]

D. Belgium; Article 1798 of the Belgian Civil Code

The article 1798 of the Belgian Civil Code recognizes the subcontractor's right to direct action / claim by the subcontractor, although the subcontractor is not responsible for his performed work towards the owner of the project. However, it is not clear according to this particular article if the subcontractor can quit his right[87].

CHAPTER B

I. Characterization of the right to direct action / claim of the subcontractor for his payment

1. Theory of restitutionary function (actio de in rem verso)

If the subcontractor's right for direct action / claim of his payment by the owner of the project is considered to be restitutionary claim, then the law that governs it should be defined by the confict of law rules for unjust enrichment[88].

According to the article 10, paragraph 1 of the Regulation No 864/2007, Rome II, the debt that results from unjust enrichment and is connected to a contract, then it is conditioned by the law of this contract. If the applicable law cannot be determined according to the article 10, paragraph 1, then provided that the parties have their

[85] See C. Lenz, *Withholding payments due to subcontractor disputes*, No. 3 Construction L. Int'l 35, at 36
[86] See J. F. Pulkowski, supra note 20, at 40
[87] Regarding the reverse right of direct action / claim of the owner of the project, although the Court of Cassation recognized the existence of the direct action right of the owner of the project towards the contractor's provider, the case law hasn't yet defined whether the owner of the project holds such a rights towards the subcontractor, see judgement of the *Cour de Cassation, 18 May 2006, R.W., 2007-2008,* ibid., at 147
[88] See J. F. Pulkowski, supra note 20, at 41

habitual residence in the same country at the time that the unjust enrichment results, the applicable law is the one of this country according to the article 10, paragraph 2. When the applicable law cannot be determined according to the article 10, paragraphs 1 and 2, then according to paragraph 3 of article 10, the applicable law is the one of the country in which the unjust enrichment took place. The article 10, paragraph 1 states that there should be an existing relationship between the parties, resulting from a contract, something that is not the case for the subcontractor and the owner of the project. Therefore, the only article that could be applicable would be the paragraph 3 of article 10 and the applicable law would be the law of the country where the unjust enrichment took place. However, the subcontractor's right to direct action / claim for his payment towards the owner of the project cannot be based on such a theory, as in both France and Spain the right is not limited to the amount that the owner of the project indeed enriched because of the work performed by the subcontractor, but there is the right of claiming the due amount based on the subcontractor contract[89], resulting to partial re-establishment of the subcontractor in relation to the unjust enrichment of the owner of the project. Moreover, the fact that according to the French law, the approval of the subcontractor by the owner of the project is presupposed regarding the terms of payment, too, is one more counterargument to the theory of restitutionary claim of the right based on the unjust enrichment[90].

2. Theory of guarantee funtion

A second theory as far as the right of direct action / claim of the payment of the subcontractor towards the owner of the project id that it functions as a guarantee against the contractual obligation undertaken by the subcontractor on the case of his co-contractor bankruptcy[91]. Therefore, basically, the right functions a guarantee of the contractual relationship of the subcontractor for his payment and it is quasi-conventional right, since it comes from a contractual difference.

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[89] ibid.

[90] Although the Brazilian legislation (article 265 of the Brazilian Civil Code) doesn't recognize the right of direct action / claim of the subcontractor, the Court of Appeals of Sao Paolo ruled that due to the fact that the owner of the project hadn't paid the contractor, while the subcontractor had fulfiled his work, the subcontractor held the right to ask for direct payment by the owner of the project with the legal basis of unjustified enrichment, see C. Lenz, *Withholding payments due to subcontractor disputes*, No. 3 Construction L. Int'l 35, at 36

[91] See J. F. Pulkowski, supra note 20, at 41

The case law of the Court of Justice of The European Union has a rather close interpretation of the contractual differences. However, a strong characteristic is the judgement *Handte*[92] that ruled that the phrase of paragraph 1a of the article 5 of the Regulation Brussels I, on international jurisdiction, the recognition and execution of decisions in civil and commercial cases *in matters relating to a contract* does not cover the case there one part is not aware of (and therefore could not have predicted) the responsibility towards the other. Furthermore, the Court of Justice of The European Union[93] has used the argument that in an "international chain of contracts" the responsibilities and the obligations of the parties can be very different in every one of the contracts.

3. Theory of the sui generis character of the right

Another theory that has been developed[94] characterizes the right of direct action / claim of the subcontractor towards the owner of the project as an unconventional, sui generis, right. According to this theory, the applicable law can be decided more freely; basically, all conditions of the case are considered in order to seek the closest contact based on which the applicable law will be decided.

Conclusions of the above-mentioned theories

The right of direct action / claim of the subcontractor cannot be characterized as restitutionary claim of the subcontractor towards the owner of the project, for the reasons analyzed above. However, either if it is characterized as quasi-conventional right, or as sui generis right the question is what law would be applicable if the subcontractor has this particular right. If the law of the main contract is the same one as the law of the subcontractor contract, things are quite simple, as one and only one law is applicable in a three-partied relationship and decides if the subcontractor has

[92] See Judgment *Jacob Handte & Co GmbH v. Traitements mecano-chimiques des surfaces SA* (17 June of 1992), ECR I-3967, ibid.
[93] Also, in the USA the Court of Appeals denied the characterization of the right as a quasi-contractual right, see *Shurlow Tile C v. Farhat*, 60 MichApp 486 (1975) of the Court of Appeals, which ruled that the work of the subcontractor was fulfilled under the contract valid between him and the contractor and so it was denied to be recognized a direct action / claim of the subcontractor towards the owner of the project after the contractor's bankruptcy, see W. F. Frey, G. Mantese, *Limits on a subcontractor's right to bring a quantum meruit claim against the property owner*, Michigan Bar Journal, October 1992, Construction Law, at 1044
[94] See J. F. Pulkowski, supra note 20, at 42

the right. Things, however, are much more complex when every contract is governed by different law.

II. The law that governs the right of direct action / claim towards the owner of the project

Definitely the subcontractor's right that results from the three-partied relationship between the owner of the project, the principal contactor and the subcontractor, protects the weakest part of this relationship: the subcontractor. In contradistinction, there is also the owner's right within the unpredictable in many cases – for himself – subcontractor's right.

So, different theories have been developed on what law governs the subcontractor's right[95]:

1. The law of the main contract

The theory, that supports the law of the main contract mainly arguments that the owner of the project requires protection against the possible payment claims (lawsuits) by subcontractor(s)[96]. So, if the law of the main contract is chosen, the owner of the project could (theoretically) predict these claims and this way, he will have the opportunity to decide who his future creditors will be.

2. The law of the principal construction contract and the law of the subcontractor contract

This theory was developed under the prism of conflicts of law and determines that the law of the main contract, as well as the law of the subcontractor contract result to the subcontractor's right.

3. The law of the subcontract

Another theory determines that the right is conditioned by the law of the subcontractor contract or as it is also called, "the law governing the secured claim". This theory is based on the fact that the particular right protects the subcontractor [97]

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[95] ibid.
[96] ibid., at 43
[97] The Supreme Court of North Carolina used a quite characteristic phrase into its judgment in *Electric Supply Co. v. Swain Electrical Co*., ruling that the direct action / claim of the subcontractor is the *cornerstone of a subcontractor's lien rig*hts, see L. A. Dabbs, *Mechanics' liens-judicial legislation at*

against the contractor's bankruptcy and so it functions as a guarantee for his payment. As a matter of fact, this guarantee is in parallel to the right of a road accident victim for direct claim against the responsible person's for the cause the accident insurance company.

4. Theory of the two-step approach to decide about the governing law

Deciding that the subcontractor's right results from the law of the subcontractor contract is the first step only. The following step is to ensure that the owner of the project is protected against unpredictable direct payment claims. There is an opinion[98] that the law conditioning the main contract should be used in order to limit the subcontractor's right, so as to ensure the protection of the owner of the project. However, it has also be arued[99] that in order to protect the owner of the project, if the subcontractor's right of direct action / claim is completely unknown to the law of the main contract, then the owner of the project should be able to practice "veto" on that right. In any case, according to this opinion, the range of such a right should not be determined or limited by the main contract[100].

5. The alternative theory

According to this theory, one of the following law systems is applicable, as long as it predicts a direct claim right: the main contract law, the subcontractor law, the law of the place of the project / work execution.

6. The French theory of «contract chain»

According to the French theory[101] the direct action / claim for the subcontractor's payment should be governed by the main contract law, but the subcontract's law should be governed by another right of the subcontractor, that is the right of direct claim of guarantee. This theory is based on the logic that the law governing every right should be the law of the contract one is part of.

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work: changes in the mechanics' lien law of North Carolina after Electric Supply Co v. Swain Electrical Co., Wake Forest Law Review, at 1040

[98] Of Lagard, see J. F. Pulkowski, supra note 20, at 43

[99] Of Jayme, ibid.

[100] ibid., at 44

[101] See V. Heuze, *La loi applicable aux actions directes dans les groupes de contrats: l'exemple de la sous-traitance internationale*, Doctrine et Chroniques, at 244

Concluding remarks of the above mentioned theories

To determine which law governs the direct right / claim of the subcontractor against the owner of the project (if the main contract and the subcontract are governed by different laws) the following issues should be considered seriously:

- Firstly, that the right aims to protect subcontractors who are the «weakest link» of the chain of the construction contracts,
- Secondly, the owner of the project should also be protected from a claim (a suit) that couldn't be predicted[102].

CHAPTER C

I. The pay when paid (or pay if paid) clause in the subconstruction

A technique of interconnection[103] between the main contract and the subcontract is the "pay when paid" or "pay if paid" clause, whereby the subcontractor agrees to be paid only when the contractor is paid for the work of the subcontractor by the owner of the project.

In the USA, this clause has strongly concerned the jurisprudence and has been a source of litigation between subcontractors and contractors[104]. A general rule developed by the majority of the judments is that the "pay when paid" clauses essentially give postponing time[105] for the subcontractors' payment, on the basis that subcontractors have a constitutional right to be paid in a reasonable time and thus they don't constitute a reason for cancellation of payment of subcontractors[106]. The argument that the subcontractors claim in lawsuits against the contractors is that even if the clause is considered a condition precedent for their payment, that is contrary to public policy[107]. The american courts' judgements are trying to clarify if both parties, the contractor and the subcontractor, had intended to include the «pay-if-paid» clause

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[102] J. F. Pulkowski concludes that is preferable to decide under the main contract whether there exists a right of direct action / claim of the subcontractor, see J. Florian Pulkowski, supra note 20, at 55-56

[103] See P. Glavenes, supra note 7, at 764

[104] See W. N. Vernon IV, *Show me the money!: A comment on the enforceability of "pay-if-paid" clauses in contracts for professional services*, University of San Francisco Law Review, Fall 1998, at 100

[105] See P. Pirodi, *Yearbook of Private International Law*, Vol.VII, 2005, edited by P. Sarcevic, P. Volken, A. Bonomi, Sellier European Law Publishers, 2006, at 293

[106] See E. N. Larson, *Freedom from the freedom to contract: California Supreme Court invokes public policy to invalidate "pay-if-paid" clauses in construction contracts*, Thomas Jefferson Law Review, October 1999, at 255

[107] See W. N. Vernon IV, supra note 105, at 102

as a *condition precedent* for the subcontractor's payment[108] and whether they expressed their intentions clearly in their contract[109].

II. International standard contractual documents

Over the years, and as the activity in the construction industry grew, international professional associations codified standard terms and clauses for construction contracts. The most known and used codification is the one by FIDIC (engl. International Federation of Consulting Engineers) for the international construction industry (in 1957, for the first time), the contracts of the Royal Institute of British Architects (RIBA), which formed the basis for the contracts of 1963 and 1980 of The Joint Contracts Tribunal (JCT Contracts); Furthermore, the contracts of the Institution of Civil Engineers (ICE), first edition in 1945, of the International Commercial Terms _INCOTERMS, The International Chamber of Commerce, The General Conditions of the Contracts for Construction of The American Institute of Architects in 1987 and more. All the above forms constitute unified approach procedures and uniform procedures that were created to facilitate the parties of a construction contract on such matters as how to conclude a contract, what will be its content, how to perform, how to resolve differences. These clauses are not mandatory and the parties can correct them or make up their own, genuine, conditions[110].

The main difference between the above forms and the contract terms and clauses that the parties include in their contract is that the second ones are the result of negotiation between the parties, the product of their agreement[111]. By contrast, the standard conditions of the construction industry were created to be used in as many works as possible and therefore, they aren't personalized. This means that they shouldn't be used without reservations[112]. Moreover, these terms were drafted without

[108] ibid., at 104-105

[109] See case *Thos. J. Dyer v. Bishop International Engineering Co.*, Sixth Circuit U.S. Court of Appeals, which held that the sub-contract didn't define with purity and clarity that the "pay-if-paid" clause applied and therefore, it was decided that the bankruptcy of the owner of the project only constitutes a reason to delay the payment of the subcontractor and not to cancel it

[110] See E. N. Moustaira, Book Review, supra note 36, at 149

[111] ibid., at 148

[112] The international construction projects require, beyond the technical knowledge, skills of the parties to the economic, legal and other manipulations (e.g. insurance coverage e.t.c.) and therefore, special attention in an agreement is required, see R. F. Cushman, J. Myers, *Construction Law Handbook*, Aspen Publishers, Volume 1, Construction Law Library, Wolters Kluwer, Law & Business, 1999, at 1836

the participation of contractors, who are indoubtely the party of a construction contract in a risky position and who accept the less good treatment.

III. The Fidic Form of Subcontract

Thirty seven years after the Fidic conditional terms, terms of sub-construction are inserted for the first time, with the **Form of Subcontract, September 1991,** as opposed to the up to time tactic of the attached schedules regarding the matters on sub-construction[113]. The Fidic Subcontract form is constituted by almost 70 clauses (articles), every one of which has its own heading and is characterized by the cross-linking to the terminology and the rules of the Fidic Red Book[114]. One of the most important clauses of the form is article 4 on the "Relation of the Subcontract to the main contract".

One of the matters that have caused the most disagreements within the subcontracts is to what extend a subcontract is referenced to the terms of the main contract[115]. A strong example is the judgement of the United States Supreme Court in *Guerini Stone Co. v. P.J. Carlin Construction Co.*, 240 U.S. 264 (1916). In that case, the subcontract had provided that the project should be executed in a manner "adreeable to the drawings and specifications" of the main contract. Due to delays of the owner of the project, the subcontractor stopped his works and claimed compensation against the contractor. The Supreme Court ruled that "the drawings and the technical specifications of the main contract" exclusively indicated how to execute the project and what project should be eventually executed and that, consequently, the ruling of the lower court that the subcontractor was committed by the main contract (and not only by the drawings and the technical specifications of the main contract) had been erroneous[116].

This matter resolves the clause 4 of the Fidic Subcontract Form that in paragraph 2 states that the subcontractor should have all responsibility and every duty as the contractor according to the principal contract regarding the project undertaken by the subcontractor. Paragraph 1 of the same clause gives the subcontractor the right to have an exact copy (on his own expenses) of the main contract (without, of course, the part that includes the fees of the contractor's work), while paragraph 3 states that

[113] See C. R. Seppala, *The new Fidic International Civil Engineering Subcontract*, ICLR 1995, at 1
[114] ibid., at 9
[115] ibid., at 11
[116] ibid., footnote 16

there is no contractual relation between the subcontractor and the owner of the project – although, as mentioned above, according to certain national legal orders the subcontractor has the direct payment claim right, despite the autonomy of his contract.

The most crucial issue for a subcontractor, his claim for payment and additional payment, is covered by the clauses 16.5 and 11.2 of the Subcontract Form. The article 16 of the subcontract model clears that the clause "pay-if-paid" is valid on a temporary basis, as it states that within 84 days from the delivery of the project that had been set by the subcontract, or within 14 days after the contractor has been paid for the sub-construction works according to the main contract and provided that 35 days have passed after the subcontractor submitted payment documents to the contractor, the contractor is required to pay the subcontractor[117]. This clause recognizes that the contractor undertakes the risk of no payment by the owner of the project, while the subcontractor should not undertake the same risk, but only the one of delayed payment by his contractual party: the contractor. Furthermore, the clause 11.2 states that the contractor is required to notify the subcontractor on a regular basis about his actions in order to ensure claims / demands that derive from the main contract and regard the subcontractor[118].

The clause 19.1 of the subcontract model "Settlement of Disputes" states that in case of disagreement, arbitrarion is provided according to the arbitration rules of the International Chamber of Commerce (ICC) that is anyhow also stated by the Red Book of Fidic[119]. However, something that has not been predicted either by the ICC or by UNCITRAL is a process of multi-party arbitration, as most of the times there result differences that involve more parties from both contracts: the main contract and the subcontract[120].

IV. Resolution of Disputes: Arbitration

In case of a survey among the contracting parties within the international contraction projects, questioning "What are the most characteristic and at the same time, more attractive aspects of the international commercial arbitrarion as opposed to

[117] See C. R. Seppala, supra note 114, at 17
[118] ibid., at18
[119] A process that, according to Roger Philippe Budin, is remarkably complex, See E. N. Moustaira, Book Review, supra note 36, at 160
[120] See C. R. Seppala, supra note 114, at 20

the judiciary resolution of the difference?" the answers would elect apart from the forum neutrality[121] the recognition and the enforcement of the judgements and, of course, privacy[122]. Privacy refers not only to the terms of the process but also to the terms of the rulings. Consequently, arbitrarion is the 'per se' way to the resolution of differences that result from construction contracts. Besides, special knowledge is required, in terms of technical, law and linguistic matters[123].

Some countries, however, assign the resolution of the disputes arising from construction contracts to the national courts of the country of the project execution that as the case always have, the country of the location / headquarters of the owner of the project. In this case, everything depends on the established arrangement in this country.

As it has been mentioned above, the Fidic Form of Subcontract also provides arbitration. The World Bank, although having adopted the Fidic Form for projects of "great importance", tends to a friendly settlement by a neutral authority as far as the resolution of disputes are concerned.

V. Liability of project defects

The projects of the construction contracts are particularly complex and complicated. A project usually begins with triumph but very rarely does it end in the same way, as the owner of the project usually finds some defect or defects[124]. There are insignificant, minor defects that, however, can be of great importance for the client (owner) or even they might seem insignificant at the time of construction and turn to important ones in the future. The first and decisive question to be asked is if there is any defect in the project, indeed[125]. The defects in a project can be distinguished in three categories: 1) Basic, substantial defect, where the project cannot be used, 2) Serious defect, that affects the sought result and the aim of the project and

[121] C. Bühring-Uhle conducted a survey amongst 68 international arbitrators and parties' representatives, which concluded that the neutrality of the arbitration process and the enforcement of the international arbitration judgements are the two most important advantages of arbitration, see C. R. Drahozal – R. W. Naimark, *Towards a Science of International Arbitration*, Collected Empirical Research, International Arbitration Law Library, at 19

[122] See M. Chirichiello, Professor F. Gelinas, *Confidentiality and public interest in mixed international arbitration*. McGill University, Faculty of Law, Institute of Comparative Law, Summer 2003, at 1

[123] See E. N. Moustaira, Book Review, supra note 36, at 160

[124] See E. F. Regjo, *Minor Defects in Construction Projects: a comparative approach*, Construction Law Journal 2009, at 344

[125] See the example of the Millennium Bridge of London, ibid., at 1-2

3) Minor defect, that is not an obstacle to the sought result and the project is considered to be essentially completed[126].

What can be stated as a general international rule is that the owner of the project cannot deny accepting the project for minor defects that do not affect the use / aim of the project and he has the obligation to pay for the project, deducting the amount corresponding to the defects, having at the same time the right to claim compensation for any additional loss having taken place resulting from these defects. However, all the above affect directly the contractor, provided that the owner of the project does not have a contractual relation with the subcontractor and the sub-construction contract is an autonomous one.

VI. Termination of the construction contract according to the Fidic Form

According to the clause 15.2 of the Fidic conditional terms (1999)[127] the construction contract can be terminated by the owner of the project. The clause 15.2, element d states that the owner of the project has the right to terminate the contract in case the contractor assigns the whole of the project to a subcontractor or part of it without previous approval of the owner of the project – a fact that derives from the character intuitu personae of the construction contract. Furthermore, the clause 15.2, element e states that the owner of the project has the right to terminate the contract in case of the contractor's bankruptcy.

According to the clause 16.2, element g, the contractor has the right to terminate the contract in case of the owner of the project's bankruptcy.

[126] ibid., at 2

[127] See Conditions of Contract for Construction, for building and engineering works designed by the employer, General Conditions, First Edition 1999

Concluding Remarks

The international construction contracts are a particularly complex matter. The co-existence of different contracts as satellites to a main contract, leads to a “legal domino”. For this reason, particular attention is required in every detail of the terms, with advice services by specializing lawyers, for the international construction contract format that would not involve complicated problems.

On the other hand, every international construction contract is different. It should be faced as a number of elements (like a barcode), that despite the fact that it contains many individual different elements (lines, numbers, different heights and sizes) it leads to one and only result: an authentic, unique imprint. They all look alike, but none is identical to the other. But this is what makes it exciting and interesting...

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