

Authors:

[E-mail✉ Shintaro Uno](mailto:shintaro.uno@nishimura-asahi.com)

[E-mail✉ Derek Tay](mailto:derek.tay@nishimura-asahi.com)

[E-mail✉ Satoshi Inami](mailto:satoshi.inami@nishimura-asahi.com)

[E-mail✉ Tomomi Murata](mailto:tomomi.murata@nishimura-asahi.com)

*This newsletter is based on information available as of November 10, 2022.

1. Introduction

Construction projects around the world have been affected by the Covid-19 pandemic, supply chain issues and cost inflation caused in part by global instability. Contractors are often left to bear the brunt of the increase in material costs and labour, with little recourse to cost sharing with the employer owing to the lack of well drafted price fluctuation or variation clauses.

In part two of this three part newsletter series, the clauses related to price fluctuations and variations in the “General Conditions of Construction Contract” (*Minkan (Nanakai) Rengo Kyoutei Kouji Ukeoi Keiyaku Yakkan*), otherwise known as the “**Minkanrengo**” standard form,¹ will be examined in relation to the relevant clauses in the FIDIC Red Book (1999) (“**FIDIC RB (1999)**”).

2. Key Differences between Price Fluctuation and Variation Clauses in the Minkanrengo and FIDIC RB (1999)

A common critique regarding the price fluctuation and variation clauses in the Minkanrengo conditions is that the clauses lack specificity with regard to timelines and methods of valuation. The Minkanrengo is often lacking in such areas and parties contracting on a Minkanrengo basis ought to set out specific provisions for fluctuations in the costs of materials and equipment, variation order procedures and the valuation of such variations.

(1) Price fluctuations

Article 29 of the Minkanrengo refers to the Adjustment of Contract Sum, and lists seven items in Article 29(1) from which the Owner or the Contractor may “by expressly stating the ground therefor, make a claim for a necessary adjustment to the Contract Sum”. The most relevant item to price fluctuations under Article 29(1) of the Minkanrengo would be Article 29(1)(e), which references a “drastic change in economic conditions, or any other unforeseeable cause”. Subsequently, in Article 29(2), increases in the Contract Sum are to be “based on the market prices at the time of adjustment unless otherwise agreed upon by the parties hereto”.

Another item relevant to price fluctuations under Article 29(1) would be Article 29(1)(f) under which the Contractor may make a claim “in a long term contract” (i.e. where the contract period is for more than a year) when the amount of the Contract Sum one year after execution of the Contract “is inappropriate and improper

¹ The version of Minkanrengo which will be analysed in this newsletter is Minkanrengo, Rev Version: April 2020.

due to an enactment, revision, or abrogation of any law, ordinance, or regulation or due to any change in commodity prices, wages and other such matters". Here, Article 29(1)(f) is similar to 29(1)(e) with regard to the vagueness of what is to be considered "inappropriate and improper"; however, commentaries on the Minkanrengo agree that if there is a drastic price inflation which was completely unforeseeable at the time of Contract execution or if it becomes impossible for the Contractor to secure a "minimum profit" without failure in obtaining material and work force, an increase in the work price, to an extent that allows the Contractor to secure such minimum profit, can be permitted.

When comparing Article 29 of the Minkanrengo to its counterpart in Sub-Clause 13.8 [Adjustments for Changes in Costs] of the FIDIC RB (1999), clear differences emerge in the form of the level of detail in which additional payments are to be made, and the method of valuation. Sub-Clause 13.8 of the FIDIC RB (1999) applies only where the adjustment data table is part of the contract, and due care should be given when choosing the relevant costs indices to apply in the contract. Amounts payable to the contractor would then be adjusted for rises and falls in the costs of labour, goods and other inputs to the work, based on both the formulae and the costs indices referred to in the adjustment data table. When Sub-Clause 13.8 of the FIDIC RB (1999) applies, the Employer would then bear some of the risks of cost increases as well.

Under Article 29 of the Minkanrengo, there are no specific timelines for the Owner to respond to the Contractor's claim for additional costs, and no specific timelines for when the Owner is to make the additional payment to the Contractor. This is in clear contrast to Sub-Clause 13.8 of the FIDIC RB (1999), which requires the relevant adjustment to be "applied to the amount otherwise payable to the Contractor, as valued in accordance with the appropriate Schedule and certified in Payment Certificates".

In order to secure the Contractor's rights to price fluctuations owing to the currently volatile global situation, clear terms ought to be agreed upon, in addition to Article 29 of the Minkanrengo. Clear procedures and methodologies are also helpful for an Employer, as Contractors may then price their works without leaving unnecessarily large buffers, resulting in more competitive bids and tenders. Employers may also save time and costs by avoiding disputes in cases where such clauses are drafted with insufficient precision.

(2) Variations

Variations are part and parcel of construction projects, and there are rarely construction projects which do not have any variations to the works. While variations may range in size, from miniscule variations that involve small adjustments to certain parts of the project, to larger variations which may even form a large percentage of the eventual Contract Price, the Employer's entitlement to instruct the Contractor to carry out a variation, or a Contractor's right to reject such an instruction, are not encapsulated clearly in the Articles of Minkanrengo conditions themselves.

Under Article 28(1) of the Minkanrengo conditions, the Owner "may, if necessary, order additional or extra [w]ork or changes in the [w]ork." Here, the Minkanrengo conditions itself do not clarify what "if necessary" means, but the commentary explains that the Owner may order variations if it is necessary for the Owner and reasonable reason for the variation is not specifically required.² As such, it is important that the Owner and the Contractor understand the nature of Article 28(1). In addition, although Article 28(3) of the Minkanrengo conditions allows the Contractor to demand compensation for loss or damage caused by the Owner's instructed variation and

² *Commentaries on General Conditions of Construction Contract, Minkan (Nanakai) Rengo Kyotei [Revised in April 2020]*, written and edited by the Committee of General Conditions of Construction Contract Minkan (Nanakai) Rengo Kyotei (published in 2021 by TAISEI-SHUPPAN CO., LTD.

Article 28(6) of the Minkanrengo conditions allows the Contractor to claim a necessary extension of time given reasonable grounds, including the change in work itself, there are no Articles which set out the Contractor's right to reject the variation instructed by the Owner for reasons such as inability to obtain necessary work force or material.

Notably, when Article 28 of the Minkanrengo conditions is compared to Sub-Clause 13.1 [Right to Vary] and Sub-Clause 13.3 [Variation Procedure] of the FIDIC RB (1999), one would find that the FIDIC RB (1999) is clear on the entitlement to instruct the Contractor to carry out variations and, further, on the binding nature of instructions to carry out variations. Under Sub-Clause 13.1 of the FIDIC RB (1999), the Contractor has the additional right to give notice that "the Contractor cannot readily obtain the Goods required for the Variation", which may be especially useful in the current turbulent conditions where materials and equipment are not easily available.

Parties contracting under the Minkanrengo conditions ought to be cognizant of both commonalities and differences between the international standard forms of contract. Agreeing to specific rights to instruct for variations, or the right for a Contractor to reject such instructions for variations, are especially important to protecting both the rights of the Contractor and enabling the Owner/Employer to plan for contingencies.

(3) Valuation and payment for variations

As stated above with regard to price fluctuations, the Minkanrengo conditions offer no methodology for valuation of Contract Sum increases. For variations under the Minkanrengo conditions, even if the Contractor carries out an instruction by the Owner pursuant to Article 28(1), there is no valuation mechanism available to the Contractor to calculate the value of the variation. The Contractor would have to rely on Article 29(2), where increases in the Contract Sum are to be "based on the market prices at the time of adjustment unless otherwise agreed upon by the parties hereto", which non-Japanese parties may find to be lacking in specificity.

In contrast, variations under the FIDIC RB (1999) will be valued pursuant to Sub-Clause 13.3 [Variation Procedure], read with Clause 12 [Measurement and Evaluation] which sets out clear procedures, formulas and methods of valuation for works carried out by the Contractor. Moreover, under the Minkanrengo conditions, payment timing for variations carried out by the Contractor is not specified clearly, increasing the risks borne by the Contractor when carrying out the Owner/Employer's variation instructions. It should be noted, however, that the FIDIC Yellow Book (1999) and the FIDIC Silver Book (1999) do not reference Clause 12. This lack of valuation mechanism has been improved upon in the FIDIC Yellow Book (2017) and the FIDIC Silver Book (2017) which now have specific valuation mechanisms for new rates or prices to be derived from "any relevant rates or prices in the Schedule of Rates and Price with reasonable adjustments taking account of all relevant circumstances" or where not applicable, such new rates or prices "shall be derived from the Cost Plus Profit of executing the work".

Japanese counterparties often propose provisions which may include discussions in "good faith" as the procedure for determining the relevant valuation of variations or payment timelines. While such provisions often may be agreed upon to maintain good will between the parties, such provisions do not provide sufficient safeguards to either party when a dispute arises.

Parties when contracting under the Minkanrengo conditions should keep such issues in mind, and agree upon clear and specific methods of valuation for variations, which are almost always unavoidable in construction projects.

3. Conclusion of Part Two of Three

Owing to the interconnected nature of today's global state of affairs, events unfolding halfway around the world may result in changes to domestic prices. In such unpredictable circumstances, parties contracting on a Minkanrengo basis may better allocate the risks of entering into a construction contract through the addition of terms which provide specific timelines or formulas to reflect price fluctuations and variations to the contract price.

In order to respond to the business needs of our clients, we publish newsletters on a variety of timely topics. Back numbers can be found [here](#). If you would like to subscribe to the N&A Newsletter, please fill out [the N&A Newsletter subscription form](#).

This newsletter is the product of its authors and does not reflect the views or opinion of Nishimura & Asahi. In addition, this newsletter is not intended to create an attorney-client relationship or to be legal advice and should not be considered to be a substitute for legal advice. Individual legal and factual circumstances should be taken into consideration in consultation with professional counsel prior to taking any action related to the subject matter of this newsletter.

Public Relations Section, Nishimura & Asahi [E-mail](#) 