GOVERNMENT CONTRACTS

By :

Dr. Jafar Bushehri

DEFINITION

The Civil Code of Iran defines a contract as follows :

« A contract is made when one or more persons undertake an obligation towards another one or more persons, on a certain thing, and that obligation is accepted by the latter persons » (1)

The essence of a contract being an undertaking, obligation or agreement can be traced in other legal systems as well :

« A contract is an agreement between two parties which is intended by them to have legal consequences » (2)

---

(1) Iranian Civil Code, Article 183.

(2) Frank, W. F. *The legal aspects of Industry and Commerce* (Third edition; London : George G. Harrap & Co. Ltd., 1964), p. 16.

Government contract being subject to certain distinctive legal rules, is unique in that the government is a party to it.

A. Comparative Remarks

Since government contracts are of importance in the relationship of governments to individuals, such contractual relationship in England, United States and France will be discussed in brief.

1. Government Contracts in England

It is asserted that the Crown cannot, by contract, fetter the future exercise of its discretion, nor hamper its freedom of action in matters which concern the welfare of the state.

Indeed, the claim by the Crown to freedom of executive action, which was allowed in 1921, (1) does not seem to have been raised again in an English case until 1948 (2). This may be attributable to numerous causes: the absence of any separate administrative courts which might tend to treat such contracts differently from civil contracts, the difficulty of proceeding against the Crown, the readiness of the Crown to observe its contractual obligations, the standard terms used in such contracts, or the comparatively narrow part which contracts played in governmental activities until recent times.

Recent developments show a distinct difference between a contract which is made with the Crown and those made with any other governmental body.

---

(1) Amphitrite *V.* The King (1921) 3 K.B. 500.

(2) Robertson *V.* Minister of pension (1949) 1 K.B. 227.

2. Government Contracts in the United States

The matter of the contracts of public authorities in the United States has been largely dominated by the constitutions. (1) In relation to the states it provides that "No state shall . . . pass any Bill of Attainder, *ex post facto* law, or law impairing the obligation of contracts." This section was later supplemented by S. 1 of Fourteenth Amendment which reads as follows :

> "Nor shall any State deprive any person of life, liberty or property without due process of law."

In regard to the obligations of Federal Government the principal provision is that of the Fifth Amendment :

> " No person shall be . . . deprived of life, liberty or property, without due process of law; nor shall private property be taken for public use without just compensation."

These provisions form a considerable safeguard to the contractual rights of individuals to the point that, would legislative actions interfere with contracts, the judicial review can control. Contracts, as such, include covenants not only with the government but between private individuals as well.

However, the necessities of government will prevail and the special position of the government, both as a contractor and litigant, will be recognized. If the contractual rights constitute a real obstacle to the performance by the government of its power functions, those rights will have to give way.

3. Government Contracts in France

The existence of the separate administrative courts in

---

(1) United States Federal Constitution, Article 1, Sec. 10. Cl. 1.

France has been significant since it has facilitated departure from the rules of the Civil Code. It has meant that decisions have been made in courts accustomed to think in terms of administrative rather than civil law, and it has meant that decisions within the field of administrative law have been taken by persons aware of both the *needs* and the *failings* of administrative bodies. (1)

B. Freedom to Contract

The development of economy in a free society depends largely upon the freedom of individuals to enter into any sort of agreement. The government must, as far as possible, refrain from interfering or placing restrictions over the wills of the individuals.

The parties to a contract are therefore at liberty to include in their agreement any terms and conditions except covenants against :

1. Imperative law
2. Peace and order
3. Good morals

C. Major Elements in a Contract

The major factors that must be considered before concluding a government agreement are as follows :

1. The Parties

The party to a contract is either a natural person or an artificial one such as a corporation.

---

(1) Mitchell, J. D. B. *The Contracts of Public Authorities,* (London : School of Economics and Political Science, 1953), p. 165.

a. Contract with a Natural Person

An administrator must ensure that the full specifications of the party to his agreement are inserted, and it must be ascertained that he has attained the age of majority.

The majority age varies in different countries. In Iran it is fixed at eighteen years. (1) Persons below that age are known as infants.

The party who has benifited from a contract entered into by an infant shall pay therefore and shall also be held responsible for any loss or damage caused as a direct result of the contract. The infant, through his guardian, shall only pay for what he has received and properly used.

b. Contract with a Legal Person

An artificial or legal person could be either a government agency or a private organization, both of which operate through their accredited officers. The statute of the agency or the articles of association of the corporation must be seen to ascertain that 1) the agency or the corporation is authorized to enter into the transactions of that nature, 2) the body within the organization who has the authority of approving the transaction has ratified it, and 3) the officer signing the contract on behalf of the organization holds his legal credentials.

2. The Object of a Contract (2)

The object of a contract could be a " thing " such as a

---

(1) The law concerning the majority age of parties to a contract enacted in 1934 (1313 Iranian calendar).

(2) The legal sources of the government contracts in Iran are the General Accounting Law of 1971 (1349), and the Regulations of Government Ttransactions enacted in 1971 (1349).

car, or an "act" such as the transportation of a certain commodity or "both" such as a factory to be erected. The nature, qualifications, scope and the amount of the object of a contract must clearly be specified. The place of delivery has also equal significance.

Expert opinion on the technical facets of the object of a contract as well as the predictable problems of delivery would facilitate and simplify the implementation of the agreement. Vagueness and ambiguity of the object is the main cause of the disputes, discrepancies and misunderstandings in contracts.

There might be some additional work or things which are not accociated with the object of the contract under normal circumstances. The contract must specifically provide for them if they are intended to be included.

3. Time Duration

The time duration of a contract must be specified; the starting date could either be immediately after the contract is signed or some other appropriate time as the parties might agree. The contract must provide for the consequences of the non-compliance with the time limits, i. e. the contract shall be annulled, or a penalty or a liquidated damage shall be payable, or an extension allowed. In the latter case the conditions for extension must be specified.

4. Performance Bond

Performance bond is an instrument, bearing a sum fixed as a penalty, binding the party to a contract to pay, should he fail to perform his obligations.

Performance bond is required to cover damages resulting from the contractor's negligence, to perform the whole or a part

of the contract, including non-compliance with the terms and conditions of the agreement.

The amount of performance bond depends upon the damages an organization might suffer through the contractor's negligence . If a contractor is required to raise the amount of his performance bond above the amount of possible damage, this would certainly increase, proportionately, his contract price. Conversely, if the bond is less than the calculated risk, the organization would have insufficient security.

A performance bond could be drawn for an amount much lower than the calculated risk, provided that the employer be authorized to hold back a certain per cent of the contract price installments when due. These shall be payable to the contractor on the satisfactory completion of the work.

5. Contract Price

The amount payable to the contractor and the conditions of payment, whether the payment shall be made at once or in installments, must be clearly stipulated.

Certain contracts require the payment of the installments at equal successive periods. This has an advantage, i.e., the budget of the organization will be easily forecasted and implemented. The disadvantage of it is that, should the contractor fail to meet the work progress schedule there will be no way to stop payment of the installments. It is therefore advisable to condition any payment upon the completion of the relevant part of the work.

If a downpayment has been allowed, the amount, date, conditions and how it will be recovered must be outlined and a security be obtained before the payment is made.

It has been noticed in some instances that the employers delay the advance payment, causing misunderstanding and suspi-

cion. The delay would not release the contractor from any of his liabilities; neither is he allowed to postpone the commencement or the completion of the work, nor is authorized to rescind the contract. All the contractor is entitled to is a 12 percent interest per annum,commencing from the date that he formally claims it unless the contractor reserves certain rights or claims in the contract. (1)

6. Termination of Contract

Generally speaking, there are two circumstances in which an employer might deem it necessary to terminate a contract.

a. Frustration of the Contract

The frustration of a contract, or the contractor's refusal to perform the contract or any part thereof would not entitle the employer to terminate the contract, unless the contract so provides. However, the employer is entitled to institute legal proceedings and get an order directing the contractor to carry out the contract. If the contractor was found unable to meet his obligations, the court would arrange the contract to be fulfilled by someone else. It is only if forcing the contractor to perform the contract proves impossible, and the contract cannot be implemented by anyone else, that a judge is authorized to terminate the contract, upon the employer's request. (2)

To avoid legal complications of that sort, which involve long, serious and tedious trial, an employer may reserve, in the contract, either the right of terminating the contract and collecting the amount of the performance bond or having the contract completed, charging the contractor with the amount incurred beyond the contract price. This could be collected out of the per-

(1) Iranian Civil Procedure, Article 719.
(2) Iranian Civil Code, Article 239.

formance bond or from any other amounts due to the contractor.

b. The Employer's Policy

The objective for which the contract had been signed, may die away or the policy of the organization or the circumstances may change making the contract entirely unnecessary. The right to terminate the contract, under circumstances of that nature, has to be reserved for the employer to prevent useless continuance of a futile project. The contractor shall, in case of termination, be entitled to the reimbursement of loss, damage, etc. and the amount of indemnity depends upon the nature and the scope of the contract, particularly that portion of it which has already been performed.

7. Contractor's Acquaintance with the Object

A contractor must acknowledge that he has a clear understanding of the object of the contract, and that he has inspected and examined the site and its surroundings, (In construction contracts) and that the quantity and quality of the work and material necessary for the completion of the work are well known to him. This would serve a warning signal to keep the contractor alert to his responsibilities before signing the contract and would estop him, after the contract is made, from claims which otherwise could be raised.

8. Liquidated Damage or Penalty

A contractor may fail to perform his obligations within the time prescribed by the contract, for which he shall be liable to a liquidated damage or penalty, unless he proves that the non-compliance with the time schedule had been due to unforeseen circumstances out of his control. (1) By liquidated damage is meant

(1) Iranian Civil Code, Article 227.

a lump sum payable for certain defaults, whereas penalty refers to a stated amount payable for every day which shall elapse between the time prescribed by the contract and the date of completion of the work.

Article 230 of Iranian Civil Code stipulates that : if a contract provides for a damage to be paid in case of failure of the parties the judge shall not add to or deduct from the amount; the party at fault has bound himself.

Arriving at a satisfactory understanding about the amount of a possible damage and inserting it in the contract would save the court's and the employer's time and expense required to establish the actual cost of the damage.

9. Variations in Plan

A contract is normally made on the basis of future needs, a prediction which may or may not come exactly true. A contract must, therefore, protect the organization from irregular fluctuations of the needs as compared with the prediction. Changing economic conditions, the public response to the project, and the extent to which the organization can accept the responsibility of being involved in the plan, are some of elements which might result in a reduction from or addition to the work. The contract must provide for the amendment of the contract price accordingly, by such sum as shall be reasonable with proper regard to all material used, and the contractor's overheads as well.

Some employers reserve the right of adding to or reducing from the work up to 25 percent, altering the contract price proportionately. In any case, the contractor must be notified in time so as to prevent damage to him.

10. Maintenance Period

Construction of roads, dams, buildings and pipelines require a period of maintenance which is normally one year beginning from the date the work is substantially complete and has passed the final test. Outstanding work will be finished during that period.

Although the purpose of the maintenance period is to relieve a contractor from his obligation after the period has expired, yet it might encourage some contractors who do not stick to their professional standards to hide defects not normally noticed during the maintenance period. It is deemed wise, therefore, to hold the contractor responsible for the defects, which normally do not come to light during maintenance period, up until covered by the statute of limitations.

11. Delivery

Differences arise where the parties to a contract do not specifically provide for the procedure of delivery. The official whose signature shall be binding must be introduced. It must be envisaged in the contract, how the disputes over quality, quantity and qualifications of the completed work or the commodity supplied shall be settled.

12. Taxes

Government agencies as well as employers are bound by law ([1]) to deduct 5% (10% for some contracts) of the amounts payable to the contractors and remit the tax so collected to the agencies of the Ministry of Finance. This must be included in the contracts, to keep both parties aware of their obligations towards the Finance Agencies.

---

(1) Iranian income tax law enacted in 1970 (1348), Articles 75 and 76.

13. Workers Social Insurance

All government and non-government agencies are required by the Law (1) to bind their contractors to insure their workers and pay their premiums in accordance with the provision of the law.

Payment of the last installment of the contract price must be conditioned on the full payment of the sum due to the Organization of Social Insurance. If the employer fails to do so he would be responsible for the payment of the premium, for which he may finally refer for reimbursement to the contractor.

14. Settlement of Disputes

Disputes over a contract could either be settled through arbitration or courts. Arbitration, if prescribed by the contract, is preferable because of the summary and rather informal procedure of arbitration.

15. Interpretation of Contract

The parties to a contract could be of different nationalities or a contract could be signed in one country of jurisdiction and implemented in another, or the residence of the parties might fall under two different legal systems. In all such circumstances, it has to be specified which law would govern in the event of an interpretation of the contract becoming necessary.

D. Problems

The following cases ensued from shortcomings in the contents of the contracts have occurred as explained below. Dates, amounts and some other immaterial parts of the cases are changed.

---

(1) Workers Social Insurance Law, Article 29.

1. A Controversy Over the Contract Price Between a Government Corporation and a Contractor

An agreement was signed on 28 November 1955 between a Ministry and a Contractor (A Joint Venture composed of three construction companies) . The subject of the agreement was the purchase of a sugar factory, its transportation to site and its erection. The Ministry, later, formed a corporation to which it transferred its rights and obligations. Thus, the parties to the contract became a Government corporation run on a commercial basis (*i. e.* free from the strict regulations applicable to Government organizations) and the contractor.

The agreement was amended on 15 August 1956, altering the end product of the factory and raising the price of the contract from $2,950,000. - to $3,350,000. -

Although the site where the factory was to be erected was chosen and delivered to the contractor in time, work did not commence in 1956 because the contractor's engineers were in doubt as to the capacity of the site soil to bear the load and withstand the vibrations of the factory during operation.

The contractor in a letter dated 4 November 1956, informed the Corporation of the prevailing conditions and predicted that a piling work might be necessary. He did not, however, specify the extent of the additional work or expenses involved. The corporation, expecting to hear again from the Contractor, but the contractor did not respond.

The soil investigation was completed in March, 1957, and the contractor diligently started piling works, raising the bearing capacity of the ground to meet the weight and the vibration of the factory. A debit note to the amount of $222,000. -

covering the extra cost incurred by the strengthening of the foundation, was later submitted to the Corporation.

The Corporation, faced with a strange, unprecedented and complicated problem, took the position of refuting the Contractor's claim. Many letters were exchanged, several Committees were held, many comprehensive reports were submitted and different alternative suggestions were made, until finally, a compromise was reached.

The following is a resumé of what the parties to the contract stated to justify their positions on the issue.

A. The Contractor's Point of View:

1. The site was selected and delivered to us by the Corporation. Since it was the corporation's decision to have the factory constructed on this particular piece of land, and since we had no part in the process of selecting the site, the corporation alone must bear the consequences of their decision.

2. The low bearing capacity of the ground was a condition beyond our control. No person can be penalized for anything over which he has no power.

3. The site was not decided on when the contract was made. The basic price of the contract was, therefore, calculated on assumed bearing capacity of normal soil. When the general locality of the site was known, a preliminary soil report was obtained which showed that the load bearing capacity was less than had been assumed in calculating the basic price.

4. The increase in original cost as per the Supplemental Contract of 15 August 1956 covered solely the difference between what would have been the cost of the factory designed to produce one product and the cost of changing the design and providing

a factory to produce two products.

It could not have included the cost of extra foundations because without further information and investigation the nature and extent and cost of the additional work on foundations could not be foreseen or calculated in August 1956.

5. The consulting engineers of the Corporation have approved the extra work done by us, inasmuch as the Corporation is benefiting from the extra piling why should they not pay for it.

6. The additional piling was done in the interest of the Corporation. Had it not been done, the ground could not have stood the weight and vibrations of the factory and the Corporation would have had to undergo a heavy loss in reconstructing the foundation and re-erecting the factory.

In view of the facts stated above, the Contractor has to be reimbursed the additional cost incurred by strengthening the factory foundation.

B. The Corporation's Answer

1. The corporation was neither obliged nor requested to consult the Contractor on the selection of the site. Its sole obligation was to choose and deliver the site and pay the price of the contract in return for which it was to take delivery of a factory, sound and free from defect. Had the ground conditions had any bearing upon the contract price, it should have been included therein because the erection of the factory, and consequently the foundations, were inseparable parts of the contract.

2. The low bearing capacity of the ground was not under the control of the Corporation either. Besides, the site was accepted without reserve, and no request was made to the Corpora-

tion to change the site. On the other hand, the Corporation was not even informed that the extra foundation was not included in the contract price. The Contractors were therefore themselves responsible for their negligence and had to bear the consequences.

It should be noted that, had the Corporation been advised of the large sum of money involved, they would have changed the site and bought another piece of land in the same vicinity at 1/10 of the cost of extra foundation.

3. & 4. Assuming the Contractor was not aware of the soil conditions of the site when the contract was signed, they could not deny the report on soil investigation which was presented to them in June 1956, long before the Supplemental Contract of $400,000. - added to the original contract price, covered not only the cost of changing the products of the factory but the consequences of it as well, *i. e.* the construction of a foundation to suit the purpose.

The contractor upon signing the Supplemental Contract had sufficient information available to calculate the cost of the extra foundation. In case the soil test was not adequate, he should have reserved the right of increasing his price.

5. The consulting engineers approved not only the foundation but the whole work as well. What this technical opinion might purport is that the Contractor fulfilled his obligation in accordance with the contract. It does not mean, in any way, that the alleged extra cost has not been included in the Supplemental Contract.

6. According to a very basic principle underlying any contract, the parties to a contract must fulfill their obligations in good will. This would not allow a party to demand more than the price set in the contract.

Moreover, if a party to a contract be allowed to dis-

urse, without obtaining sanction a large sum of money upsetting the financial balance of the contract it would destroy the whole philosophy of contracts concerning the common intention of he parties.

Taking all above circumstances into consideration the Contractor should bear the extra expenses, and the Corporation has no obligation to reimburse the whole or any part of the claim.

2. A Controversy Over the Implementation of a Contract Between a Government Corporation and a Contractor.

On April 5, 1956 a contract was signed between a Corporation (whose sole share-holder was the Gevernment) and a Contractor. The object of the contract was the construction of a water pipeline, the time limit seventeen months from the date of the contract. The implementation of the contract was postponed as a result of the divergence of the old roadways and the construction of new roads which affected the direction of the pipeline.

It was agreed that as soon as the pipeline was substantially complete and capable of transferring water from the base point to destination, at the designed throughput, the Corporation would issue a completion certificate and the maintenance period during which the Contractor would be responsible for repair would commence from the date of such certificate. Article 31 of the contract dealing with the maintenance period stipulated that:

"The Contractor shall execute all such work of repair, reconstruction and making good the defects, imperfections, shrinkage or other faults as may be required by the Corporation in writing during a period of one year from the date of the Certificate of Completion."

After the work was completed and the maintenance period had expired, the engineers of the Corporation, during a routine checking, observed that the pipeline wrapper had been detached from the metal surface at some points and that corrosion was developing underneath.

The matter was brought to the notice of the consulting engineer who had issued, on behalf of the Corporation, the Certificate of Completion. The Consulting Engineer stated that the corrosion was normal and that it would not penetrate any more. But, contrary to the engineer's prediction, the corrosion did later develop very severely.

The Contractor was notified of the critical state of the pipeline but the answer was that they would neither indemnify the Corporation nor repair the wrapper.

The following is a summary of the argument between the Corporation and the Contractor.

The Contractor is of the opinion that his obligation in repairing defects in accordance with Article 31 of the contract is not absolute, it is rather limited to such imperfections which may be brought to the notice of the Contractor within one year from the date of the Completion Certificate. Since the defect has been declared after the expiration of the time limit, the Contractor is not bound to remedy, because no contractual obligations continue to exist after the maintenance period.

The Corporation answers that no sanction has been provided for the noncompliance with the provision of Article 31. In other words it has not been specified in that Article that if the Corporation does not inform the Contractor of the defects it shall be barred from claiming redress.

The Contractor replies that were his obligations to continue after the maintenance period, Article 31 would serve no purpose. By this Article, he claims, it was meant that the machinery and equipments utilized for the implementation of the contract be removed from the site and the specialists, engineers and all other men hired for the contract be released for engagement in other business, and the contract be considered accomplished for all purposes.

The Corporation argues that Article 31 refers only to the defects which are normally discovered during the period of one year. It therefore, does not include basic imperfections which reveal themselves in the course of time. The abnormal corrosion of the pipeline which has been due to inadequate cleaning of the pipe and improper tension of the tape at the time it was applied are the type of defects not within the purpose of Article 31 and can only be barred by way of the statute of limitations.

The Contractor argues that the Corporation, through its Consulting Engineers, has exercised close supervision over the performance of the work and confirmed his adherence to the approved standards as the work progressed. He claims that the final certificate signed and issued by the Engineer liquidates our outstanding obligations and renders the claim for repairing the corroded pipeline unfounded.

The Corporation answers that the function of a consulting engineer is not of an executive nature. The consulting engineer does not interfere in the execution of the work. He is not a watch-dog and is never expected to be present at every stage of the progress of the work reminding the Contractor of his errors or failures. The purpose of the maintenance period envisaged in any construction contract is to provide for any such defects and imperfections as may result from the contractor's negligence and is not a substitute for the supervision enacted by the consult-

ing engineer who merely exercises a broad and over-all control over the implementation of the contract.

Moreover, the Corporation argues, a consulting engineer issues his final certificate under the impression that the work has been completed in accordance with the agreed norms, and no contractor should take undue advantage of his assumption should this turn out to be false. The abnormal corrssion of the pipeline, resulting from the contractor's negligence while coating the pipe, leaves no doubt that the certificate has in fact been issued under such false impression.

The parties to this contract, the Corporation maintains, had definitely not intended to draw up the contract in question with a view to construct a damaged and corroded pipeline, wrapped contrary to the accepted standards. Assuming this to be true, the parties concerned should not construe Article 31 to give an erroneous conclusion.