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Recent decisions of Chile’s Supreme Court: can contractors expect a more balanced approach?

Elina Mereminskaya Tuesday 27 September 2022

Under Chilean law, public entities cannot enter into arbitration agreements unless they have been specifically authorised by law.[1] For example, the Law of Concessions of Public Works establishes a specific ad hoc arbitration mechanism,[2] which allows disputes subject to this law to be resolved through such a mechanism. However, disputes arising from other types of public contracts – general construction contracts, design and build, etc – are usually submitted to the ordinary courts.

An unpublished analysis carried out by Wagemann Lawyers & Engineers of Supreme Court decisions issued in the last decade and involving the state, the treasury and local authorities, revealed that in 51 per cent of the cases considered, the contractors’ claims were rejected in their entirety. In 29 per cent of the cases, the contractors obtained less than half of the amount claimed, and they only obtained more than half of the amount claimed in the remaining 30 per cent of the cases.[3]

This article discusses five of the most relevant decisions issued by the Chilean Supreme Court so far during 2022. For a better understanding of the case law discussed below, three general features of the Chilean legal practice are relevant:

• The regulations applicable to public contracts tend to transfer a wide range of risks to the contractors, even those which are beyond the contractors’ control.[4] This sets a rather prejudicial framework to the contractors’ general interests, which may explain the low rate of success before the courts.

• During the execution of the works, it is not unusual for a public entity and a contractor to sign a modification agreement granting the contractor a time extension but providing no compensation for cost overrun. Such an agreement usually includes a waiver of all claims that the contractor could have raised at that point. Contractors tend to accept these agreements and waivers to avoid the application of delay damages. Nonetheless, in court proceedings, they tend to revive their claims despite the waivers included in the modification agreements.

• The cases that will be analysed below reached the Supreme Court by way of recourse of cassation (casación), which is an extraordinary recourse aimed at annulling the Court of Appeals’ decisions only where the decision is based on errors of law. The Supreme Court can either accept or reject a request for cassation, and, in that last case, it can issue a replacement decision. However, the Court is bound by the facts as established by the lower courts. Consequently, the Supreme Court is often limited in its powers, as it cannot access new evidence, for example, a new calculation of damages.

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Supreme Court, Case No 63,190-2021, *Empresa Constructora Salfa S A con Fisco de Chile*, 21 January 2022

The court of first instance and the Court of Appeals of Santiago rejected the claim for damages filed by Constructora Salfa S A (Salfa) against the Ministry of Public Works (MOP). The case involved a road construction project in which the original execution period was 540 calendar days and for which four modifications were subscribed. Salfa alleged that the MOP breached the contract in failing to grant timely access to the site, resulting in an increase in the direct costs: namely labour, machinery and diesel. Salfa argued that it was entitled to claim the direct costs plus 30 per cent of the values of those costs to compensate for general cost and overheads in line with Article 138 of the Public Works Construction Regulations of the MOP (RCOP).[5]

Salfa argued that the bidding terms did not contain a schedule for handing over the site and, based on the RCOP provisions, MOP should have handed over the entire site no later than 15 days from the date on which Salfa had fulfilled certain formal requirements.[6] However, the MOP handed over the land in instalments, according to the progress of the expropriation process conducted by the state, which caused it more than ten months of delays.

The Supreme Court rejected Salfa's request for cassation relying on the finding of the Court of Appeal that in

> 'clause 7.2 "Official Programme" of the Bidding Terms, it was expressly established that the contractor should schedule the execution of the works according to the status and procedural status of the expropriations of the project land and that the same would have occurred with the land occupied by the electricity poles' (Consideration 9).

In other words, the Supreme Court understood that the bidding terms did indeed include a provision on the handover of the site as the contractor was under obligation to plan the works according to the advancement of the status of the expropriations of the land. Therefore, the MOP did not breach the contract by handing over of the site in instalments.

By way of *obiter dictum*, the Supreme Court highlighted that, in all four modification agreements signed by the MOP and Salfa, 'it was recorded that the claimant expressly waived the right for any compensation for extension of time of the contract' (Consideration 6).

Two brief conclusions follow from this decision. First, the way the bidding terms provisions were construed by the courts requires contractors to program the works based on the unknown progress of the expropriation process conducted by the state. It creates a supposition which is at odds with the real-world exercise of construction activities and assigns the contractor an unforeseeable financial burden. Second, all waiver of their rights signed by the contractors will be interpreted by the courts strictly and held against them.

Supreme Court, Case No 5,342-2021, *Constructora Alvial S A con Municipalidad de Peñalolén*, 24 January 2022

Constructora Alvial S A (Alvial) filed a claim against the Municipality of Peñalolén, alleging that the 'Construction of Las Perdices Peñalolén Park' project was extended by 190 days in addition to the 300 days established in the contract, causing an increase in general costs and overheads for the contractor.

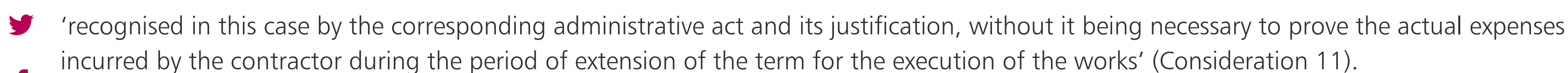
The Municipality granted a 190-day extension due to the illegal occupation of part of the land by third parties and because of extraordinary works it had instructed the contractor to perform. Nonetheless, the Municipality argued that the contract was entered on a lump sum basis, which meant that Alvial should have foreseen and covered the additional expenses generated by the works.

Alvial claimed the proportional daily value of the general cost, multiplied by 190 days. The court of first instance ruled that Alvial did not prove the actual damages and rejected the claim, which was confirmed by the Court of Appeals of Santiago.

The Supreme Court, relying on Article 147 of the RCOP, found that where an instruction is issued by a public entity modifying the contractor's work schedule, the contractor must be

> 'compensated for the higher overhead costs proportional to the increase in the term incurred. To this effect, and in the silence of the bidding terms, the general costs/overhead should amount to 12% of the total value of the proposal and the compensation will be proportional to the increase in time in relation to the initial term' (Consideration 8).

In the same vein, the Court ruled that in such cases, it was sufficient to show that the extension of time was due to the instructions of the public entity, which was



> 'recognised in this case by the corresponding administrative act and its justification, without it being necessary to prove the actual expenses incurred by the contractor during the period of extension of the term for the execution of the works' (Consideration 11).

e Supreme Court accepted cassation and issued a replacement ruling, in which it considered that some of the modification agreements included contractor's waiver of its right to seek compensation. Consequently, Alvial was given damages equivalent to the overhead daily value, applied to 0 days unaffected by the waiver.

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e decision renders a more positive outcome for the contractor. It is valuable that the Court rejected the view that the lump sum price should ver all contractors' costs and damages, even those caused by the direct intervention of its counterparty. However, the Court also applied the waiver included in the extension of time agreements, reducing compensation owed to the contractor.

Supreme Court, Case No 124,397-2020 *Épsilon Asesorías y Proyectos S A con SERVIU*, 11 April 2022

The Public Housing and Urban Development Service (SERVIU) entered into four contracts with the construction company Épsilon Asesorías y Proyectos S A (Épsilon). SERVIU committed a series of breaches, disrupting Épsilon's performance. Even so, SERVIU collected the guarantee bonds corresponding to each of the four contracts. This triggered Épsilon's inability to respond to its contractual and legal obligations, which led to its inclusion in a public registry of debtors. However, pursuant to SERVIU's own regulations, its contractors must have a sound financial background and cannot have unpaid obligations.

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The Supreme Court determined that SERVIU breached the contract, acting with inexcusable negligence. The improper collection of the guarantee bonds caused the particular financial situation that affected Épsilon, which became unable to continue in the contracts it had in force and was prevented from participating in new tenders conducted by SERVIU. It was therefore shown, in general terms, that the contractor suffered damages. The relevant issue which remained open was the specific amount of damages.

The Supreme Court accepted Épsilon's request for cassation of the second-instance unfavourable decisions and issued a replacement ruling. The Court made an effort to quantify the specific damages, but always within the limits imposed by cassation, that is, without being able to establish new facts. Due to certain omissions in the claim, the Court was only able to award loss of profits of the expected annual profits under the contracts that had been terminated when Épsilon became financially unreliable.

At the same time, the Court did not find sufficient evidence in the file to project these amounts to future possible contracts and ruled out damages for lost opportunity. The Court contended:

> 'The projection of loss of opportunity must be based not only on data from previous years, but also on other data referring specifically to the actual activity of projects developed by the SERVIU in the following years, in order to establish the real possibilities of the claimant to participate in those projects, and the amounts that such participation could have meant, as an initial parameter for calculating the value of the chance' (Consideration 7 of the replacement decision).

This case is somewhat notorious as it accepts the possibility of claiming damages for loss of opportunity and for providing general guidelines on their calculation.

Supreme Court, Case No 63,273-2021, *Empresa Constructora Santa Elena Limitada con Municipalidad de Buin*, 9 May 2022

Constructora Santa Elena (Santa Elena) argued that the original contract term of 180 days was extended three times, due to the Municipality of Buin's failure to give access to the work areas, extending its duration by an additional 270 days. It claimed damages for general costs and overheads, originally estimated at 13 per cent of the net budget of the works. The first- and the second-instance tribunals ruled in favour of Santa Elena, awarding it the amount claimed, as was quantified by an expert report.

The Municipality submitted a request for cassation, arguing that, although the parties agreed on three extensions of time, it was a lump sum contract in which a lump sum was established, with no possibility of its increase except in the case of *force majeure*. On the other hand, the bidding terms and conditions did not provide for payment of the overhead in the case of an extension of time.

The sound approach taken by the first-instance tribunal is noteworthy, which the Supreme Court reproduced in its ruling, stating that, although the public entity has the possibility of unilaterally altering the contract,

> 'it appears as an elementary imperative of justice that the exercise of this prerogative finds limits as the private contractor is not under the obligation to bear public burdens that do not correspond to him, under the pretext of the need of the authority to ensure the common good' (Consideration 5).

e Supreme Court took into consideration that, first, the Municipality did not provide reliable and truthful information at the time of the tender ce it had not disclosed that certain work areas were not yet available; and second, the execution time was increased due to the same reason of k of areas.

th respect to the nature of the lump sum contract, the Supreme Court held that it was not in accordance with contractual good faith to interpret s type of price determination 'in the sense that the contractor cannot request compensation for higher expenses arising from the extensions of e not attributable to it' (Consideration 5). The Court reached this conclusion by applying both the RCOP and the general rules on contractual oility. Consequently, the cassation filed by the Municipality was rejected.

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Here once again, the courts have rejected the surprising argument that the lump sum price would cover all costs and damages, even those directly caused by the public entity. This case offers a correct interpretation of contractual and legal provisions and leads to a result that is in line with the commercial expectations of construction companies.

Supreme Court, Case No 71,675-2021, *Constructora Tara Compu Ltda. con Fisco de Chile*, 23 May 2022

The factual background of this case and the rules applicable to it are almost identical to the first case reviewed above. Indeed, the contract did not provide a schedule for the handing over of the site area by the MOP and included the same clause 7.2 of the bidding terms, which requires the contractor to schedule the execution of the works according to the status and procedural status of the expropriations of the project. This also applied to the land occupied by the electricity poles.

The MOP agreed to three amendments to the contract in which it gave a time extension of over 300 days to Constructora Tara Compu Ltda. (Tara) but denied the contractor's request for additional costs. Tara's claim was rejected by the first-instance tribunal, which was confirmed on appeal.

The Supreme Court concluded that Tara's claim lacked merit as it was contrary to the parties' original agreement and was at odds with the practical way the parties performed the contract. In the Court's view, the parties originally agreed on the partial handing over of the land and this was the way in which the contract was executed, as was shown by the three amendments that adjusted the contractual timeframe. Tara's request for cassation was rejected.

Final remarks

In three out of the five cases, the Supreme Court construed the applicable rules within the usual boundaries of interpretation techniques. As a result, the Court construed the applicable provisions liberally, reaching equitable and commercially sound conclusions favourable to contractors.

In the other two cases, the literal wording of the applicable provisions led the Court to a more restrictive position, creating an assumption that the contractors had accepted the risks associated with the expropriation proceedings conducted by the state, thereby resulting in an outcome which is not reasonable from the view of the contractors' contractual expectations.

To conclude, if contractors consider their participation in public tenders in Chile, the following reflections are worth noting. First, the disputes arising out of those contracts will be submitted to ordinary courts, which statistically speaking tend to favour the state. Second, contractors should pay particular attention to the written terms of the bid documents. If certain risks have been allocated to them by way of these documents, it is unlikely that the courts would revise or reallocate such risks. Third, the public entities often tend to grant an extension of time for causes not attributable to contractors. However, they deny contractors' requests for additional costs, and insist that contractors waive their rights to claim cost and damages. Such types of waiver should be resisted by the contractors as, if formally accepted, they will render subsequent court actions unsuccessful.

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[1] This limitation derives from Arts 6 and 7 of the Chilean Political Constitution that establishes 'the legality principle', which means that state bodies can act strictly within the boundaries established by law.

[2] Arts 36 and 36bis of the Decree with the Power of Law No 164 from 1991 (Public Works Concessions Law), which has been updated on various occasions being the Law No 20.410 of 2010 one of its most relevant modifications established a two-tier system. The first tier is mandatory, whereby the dispute is submitted to the Technical Panel entrusted with matters related to technical or economic discrepancies. The second tier includes a recourse to an ad hoc arbitration before the Arbitration Commission.

[3] This conclusion is consistent with the general statistic that argues that the Council of Defence of the State wins between 70 and 90 per cent of all cases. José Miguel Aldunate, 'El Estado ante los tribunales', *Diario Financiero*, 6 September 2018, www.df.cl/opinion/columnistas/el-estado-ante-los-tribunales accessed 21 July 2022.

[4] See the most relevant regulations: Supreme Decree No 75 of the MOP of 2004, which approves the 'Regulation for the construction of public works'. This document regulates a classical construction contract in which the design is provided by MOP. Supreme Decree No 108 of 2009 of the MOP, which uses the Design & Build delivery method. Also, the Ministry of Health, through its Undersecretariat of Health Care Networks, applies Resolution No 160 of 2015 for the construction of public hospitals, which also follows the Design & Build approach.

[5] RCOP Art 138 provides: 'If the failure to deliver the land is not attributable to the contractor and causes him delays in relation to said programme, he shall be compensated for damages, based on the justified direct expenses incurred by the contractor and verified by the fiscal inspection, plus the percentage established in Article 105. Likewise, the term of the contract shall be increased in accordance with the delay caused the indicated reason.' In turn, RCOP Art 105 provides: 'In the absence of agreement, in case of urgency, the execution of such works may be lered, and the contractor shall be paid the proven direct costs, plus 30% of these values to compensate for general cost and overhead. Payment l be made upon approval by resolution of the details and justification of such expenses.'

RCOP Art 137 states: 'The schedule for delivery of the land and the layout with its various modalities shall be established in the bidding cuments. If nothing is indicated therein, handover shall be made within 15 days following the date on which the contractor or its legal resentative complies with the provisions of the preceding paragraph and subscribes to the background information indicated in Article 90.'

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