Introduction to German Construction Law

by Natalie Keller, Partner

HFK Rechtsanwälte, Heiermann Franke Knipp, Germany*

German construction law comprises two basic fields - public construction law and private construction law. Public procurement law is also relevant. As a specialized firm for construction related and real estate matters, HFK Rechtsanwälte covers the entirety of the aforementioned fields with a focus on private construction law, public procurement and real estate.

Public Construction Law

Public construction law concerns all public regulations on construction and is divided into two fields - zoning law and building regulations. Zoning law regulates urban and regional planning, including infrastructure and industrial development. Zoning law sets forth the procedures for governmental decision-making concerning public projects and the admissibility of private ones. The main source of public construction law is the federally legislated Building Code.

The law related to building regulations defines exactly how to build. It includes such regulations as the permissible eaves height, the minimum distance to a neighboring property, safety regulations regarding static, materials, constructive details and fire protection. Building regulations can even determine the design of a construction project, which must comply with the characteristics of a given region. Each federal state has its own building law, but these laws are largely congruent. In addition, there are regulations on conservation, energy saving etc., and specific regulations on the municipal level.

Every building in Germany must comply with all public laws. A building permit is a compulsory requirement.

Public Procurement Law

In public procurements, the contracting authorities are bound to award contracts under certain rules. In short, procurement must be economical and fair. The current procurement rules are a combination of European directives and national rules. Public procurement law is primarily focused on public authorities and public corporations, but also covers certain enterprises related to public needs. From certain threshold values onward, contracting authorities must comply with European and national tender regulations for all acquisitions. The current threshold value for public construction is set at € 5.15 million, which triggers compulsory Europe-wide contract notice requirements and application of certain procedural
rules. For acquisitions that remain under the threshold value, specific national and regional procurement regulations must be observed.

While every step made by contracting authorities is strictly regulated, tenderers must also comply with a set of formal criteria. Tenders that failed to comply with these criteria by, for example, altering the provided tender documents or submitting incomplete or delayed ones are excluded from consideration. The remaining tenders are evaluated according to a catalogue of criteria, which must be included in the invitation to bid documents. All procurements are conducted under the same principles of equal treatment, transparency, competition, proportionality and promotion of SME companies. Tenderers have to prove their skills, efficiency, experience and reliability.

Tenderers can take legal action at the bodies responsible for appeals (chambers) in the event they wish to challenge the procurement procedure or to assert defects in the invitation documents or competing tenders. If successful, the procurement procedure must be repeated and/or the tenderer can claim compensation.

**Private Construction Law**

On the private side, German construction contracts are surprisingly short. This is because the German Civil Code as well as the VOB/B-terms and conditions provide a substantial basis for most aspects of any contract.

The prototype for construction contracts is found in the Civil Code, usually translated as “contract for work and services” (Werkvertrag). Under this type of contract, as distinguished from a “contract for services,” it is the finished product, and not the work itself, for which payment is made. Consequently, the contractor is largely free to organize and carry out the work in the manner it sees fit. Only the date of acceptance is decisive. Another basic rule is first work, then pay - softened by the right of the contractor to demand on-account payments and surety bonds. Further, the ordering party is free to terminate the contract at any time. Without a genuine reason for the termination, however, the ordering party is still obliged to pay the full price, less spared expenses basically resulting in recovery of the full profit margin by the contractor. With respect to defects, the contractor must be granted an adequate chance to perform remedial work before the ordering party can replace the contractor and claim related costs.

All the basic rules discussed above come into effect automatically under the Civil Code and, therefore, apply to every construction contract. As a result, construction contracts theoretically require only two additional terms: specification of the required work and the price. In fact, many private construction contracts are concluded on the basis of the Civil Code with relatively little other verbage.

In the commercial sector, virtually every construction contract uses a set of standardized contract terms for construction contracts known as the VOB/B. For
contracting public authorities, use of the VOB, is mandatory. The VOB/B is one of three parts of the VOB, an abbreviation standing for “procurement- and contract regulations for construction work.” VOB/A deals with procurement rules, VOB/B provides standardized contract rules, and VOB/C states particular technical regulations. Under the VOB/B, a contract can also be concluded by merely specifying the work to be performed and the price. The basic construction terms set forth in the VOB/B are consistent with the Civil Code and also certain more specific provisions.

Among those more specific terms in the VOB/B are those concerning change orders and payment for extra work. The builder is free to make changes in the work at any time, but is required to pay any related costs. Also, the builder can demand the completion of extra work, provided that it stands in close relation to the original specifications (otherwise it is subject to a possible separate agreement. The parties should, but quite often do not, come to an agreement on the payment for extra work). The VOB/B provides that the new price for addendum work must correlate with the so-called original calculation, i.e., the contractor’s pricing as set forth in the contract. In other words, the contractor is bound to his own calculation of costs throughout the whole project. If the parties do not agree on a price, it can be determined through judicial review. Factors like market-price increases are considered relevant. In fact, the new price must take into account all factors that were not foreseeable at the time the original agreement was executed. Such additional costs are paid by the builder. On the other hand, the contractor is bound to his profit margin and his original calculation of indirect expenses, including overhead costs, etc. The rule of thumb is that “fat price remains fat, lean price remains lean.” While calculations, of the contractor’s indirect costs, are generally considered to be confidential, they must be disclosed when necessary to verify addendum prices. In practice, a hardcopy of the calculations is handed over by the contractor in a sealed envelope, and if necessary, both parties together will examine the respective calculations. Negotiations over changes often lead to serious disputes, and handling these disputes makes up a good part of the legal counseling in German construction law.

Other terms of practical importance are construction time, terms relating to work schedules, and terms relating to payment. With regard to these issues, the VOB/B provides several conditions. One side is the contractor’s duty to perform on schedule and, if the contractor fails, correctives (such as setting time limits) and penalties (such as damages and/or termination). The other side is hindrance, i.e., delays to the work beyond the contractor’s responsibility, with consequences for extensions to schedule (extra time) and payment (extra payment).

The VOB/B also defines the typical roles and responsibilities of the contracting parties, including organization and disposition on the one hand and cooperation duties on the other. Customized contracts often include specific terms on the organization of the construction site, meetings, reports, and planning competencies. The latter is important because, in many cases, the builder and contractor share the
responsibility for planning. A typical allocation of these responsibilities calls for the builder to provide the conceptual design, the approval design and the engineering, while the contractor provides the detail planning and the work drawings. This division of responsibility for planning is another potential cause for serious conflicts and disputes.

The VOB/B explicitly requires that all defects and flaws must be remedied immediately, while under the Civil Code the question whether work is defective is not pertinent until the acceptance date. The rationale behind the explicit VOB/B term is to give the builder the chance to address defects immediately, so as to avoid resultant costs and damages. The builder can give notice of the defect and demand that it be remedied within a reasonable period. If this period expires without the defect being remedied, the builder can terminate the whole contract or, under certain conditions, the respective part of the work, and have it finished by a different contractor. The original contractor is, in turn, obligated to pay any resultant costs. With regard to defects that occur after acceptance, the VOB/B also provides rules that address remedies, compensation claims and periods of limitation.

Further terms of the VOB/B refer to the acceptance of sureties and to unexpected damage caused by force majeure. The VOB/B also contains elaborate rules that address termination rights. Clauses on accounting and payment may also be of interest. As a general rule, the final payment is due at the moment of acceptance. Additionally, the VOB/B requires a formally correct account settlement. In other words, the contractor's account must be auditable, i.e., comprehensible for the builder. Final payment is not due until the builder has finished the audit, or for a period of two months beginning with the receipt of the account. This has the effect of postponing the payment date, compared to the basic rule in the Civil Code, where payment is due at the time of acceptance.

**Validity of Terms and Conditions: AGB-law**

Based on the notion of equality, no party to contract shall be placed in an advantageous position by using ready-made, biased terms and conditions. The German Civil Code is quite strict in judging which terms and conditions of a contract remain effective and which cannot survive judicial review. If one party provides a catalogue of standard conditions, the law on so-called General Terms and Conditions (AGB) automatically applies. Only individually negotiated clauses are not subject to the AGB-law. The definition of genuinely negotiated and individual clauses, however, is very restrictive. Most building contracts are judged upon the compliance with the AGB-laws and must meet these criteria. If a contract clause is considered invalid under AGB-law, the respective matter is judged according to the Civil Code. AGB law also applies to the VOB/B clauses if they are altered even slightly or any term is omitted.
Technical Standards and Regulations

Construction work is regarded as free of defects when it fulfills all the requirements of the contractual specifications and complies with the technical standards. Therefore, certain technical standards apply even if not explicitly described in the specifications. The generic term for these standards is literally the “Generally Accepted Rules of Technology” (here shortened as GART). This term is used in the VOB/B, and the Civil Code is interpreted to refer to these standard terms as well. A higher or lower standard than the GART can be required by contract, but must be set forth expressly in contract terms. The GART are similar to, but not exactly the same as, state of the art/technology, as that concept is understood in Germany. Strictly speaking, state of the art is a higher standard, but the two terms are often used synonymously. A rudimentary definition of GART is: scientifically acknowledged, yet practically established standards.

There is no code listing all of the accepted rules of technology. The most prominent are the catalogued standards called DIN (originally German Industrial Norms), which are published by a private institute by the same name. The majority of all German technical standards are DIN. Thousands of DIN cover all conceivable subjects, not just construction. The European Norms (EN) are also increasingly important. When nationally implemented, these are called EN-DIN. While there are numerous other published standards, it is the actual technical practice, and not the written standards, that are determinative. A particular group of DIN is the VOB/C, which is automatically incorporated when the VOB/B applies. The VOB/C is an elaborate catalogue of detailed work steps, measuring and accounting rules for every craft.

Procedural Law and Arbitration

For cases involving public construction law issues, such as building permits, the administrative jurisdiction is competent; for procurement matters it is the said chambers and the civil courts. The civil courts generally address all issues regarding construction contracts. Separate bodies specializing in construction law are found at the higher courts. At the lower courts this is not standard, but depends on the local courts’ organization. Disputes are generally heard in the jurisdiction where the building at issue is located or where the offices of the builder or contractor reside. Where international parties are involved, special conditions apply.

There are several possibilities for extra-judicial resolution of disputes such as arbitration, conciliation and mediation. In particular, arbitration procedures are widely accepted in the construction industry. Two proper statutes were designed, the “rules on arbitration and conciliation for construction issues” (SOBau), and the “arbitration code for construction including plant engineering” (SGO Bau). The application of one of these codes is quite frequently fixed in construction contracts. As a rule, the arbitration body consists of at least one degree lawyer or judge.
Recently, adjudication procedures following the British model have been discussed, and there is the intent to implement this type of arbitration into the national Code of Civil Procedure. In addition to alternative means of dispute resolution, alternatives for the prevention of conflicts have also been discussed, including construction partnering. With regard to such measures, improvement to the German system seems possible, though on the far horizon. In this regard, there is a lot to be learned from US-American practice.

- Natalie Keller is a guest author and partner in the Berlin, Germany office of the German law firm, HFK Rechtsanwälte, Heiermann Franke Knipp, which also has other offices in Frankfurt, Hanover, Hamburg, Munich, Germany and Vienna, Austria. Watt, Tieder, Hoffar & Fitzgerald, L.L.P. and HFK Rechtsanwälte are affiliated to help with your international legal issues. Future newsletters will include articles from HFK Rechtsanwälte attorneys to introduce you to that law firm. HFK Rechtsanwälte's website is: http://www.hfk-rechtsanwaelte.de/englisch/home.php