

FIDIC: Red Yellow and Silver Books – the treatment of unforeseen physical conditions

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Introduction

Whilst the FIDIC standard forms have their origins in the fourth edition of the ICE Conditions of Contract,¹ they have been exported to both common law and civil law jurisdictions and are nowadays widely encountered in projects in west, east and northern Europe, the Middle East, Africa, the Far East, China and South America.² FIDIC forms of contract are also sometimes encountered on UK projects, notably where international clients, contractors and their advisers look to use an ‘international’ standard form as a basis of their contract.

In this article, I want to examine how some of the FIDIC forms of contract treat the issue of unforeseen physical conditions. I shall also look briefly at the prerequisites for advancing a claim for extra time or money under the FIDIC forms and comment on a recent case decided in the Technology & Construction Court in London concerning the FIDIC Yellow Book.

Contract administration under FIDIC

This article starts by focusing on these issues in context of the Red, Yellow and Silver Books (there are others). The Conditions of Contract for Construction (the Red Book) is designed for traditional procurement, where the Contractor constructs according to the Employer’s design. Valuation under the Red Book is based on a bill of quantities with unit rates; it is not a lump sum contract. Further, under the Red Book a third party independent Engineer administers the contract on behalf of the Employer. The Engineer is also present under the Conditions of Contract for Plant and Design - Build (the Yellow Book) where the Contractor is responsible for errors in the Contractor’s Documents but generally speaking not for errors in the Employer’s Requirements.³ In contrast, under the Conditions of Contract for EPC Turnkey Projects (the Silver Book), there is no independent Engineer and the Contractor is responsible for all of the design and construction activities. Such hard delineations are often adjusted in practice; the FIDIC forms represent a starting position for negotiation and are very often changed.

However, the key point is that the Engineer occupies an important role under FIDIC Red and Yellow Books as he acts both as Employer’s representative for the purpose of administering the contract in issuing instructions for Variations and the like, as well as acting in a neutral capacity in evaluating entitlements that arise such as adjusting the Time for Completion for Variations. Under the FIDIC Silver Book, conceptually design responsibility is allocated to the Contractor who is paid to provide a turnkey solution so the need for an Engineer to administer the contract is removed. However, this is another hard delineation that is seldom maintained in practice on turnkey projects using FIDIC Silver; the Employer will often want its Engineer to act as the Employer’s Representative, to perform certain administrative and other tasks otherwise allocated to the Employer. For instance, this could be for the purpose of issuing Determinations under Sub-Clause 3.5 or assessing entitlements to additional time or money under Clauses 8 and 14.

¹ Published in January 1955, with the first edition of the FIDIC Red Book being published in 1956.

² FIDIC is less prevalent in the North American market because that market already has a corpus of its own standard forms of engineering contract.

³ Under Clause 1.9 of the Yellow Book, it is provided: “If the Contractor suffers delay and/or incurs Cost as a result of an error in the Employer’s Requirements and an experienced contractor exercising due care would not have discovered the error when scrutinising the Employer’s Requirements ... the Contractor shall give notice to the Engineer and shall be entitled subject to sub-clause 20.1 to ... (a) an extension of time ... and (b) payment of any such Cost plus reasonable profit...”

Allocation of risk for ground conditions

An important feature of the Red, Yellow and Silver Books is the degree to which risks are allocated to the Contractor in relation to unforeseen physical conditions. The approach taken by standard forms of engineering contract to this risk has, traditionally, been to adopt a test of foreseeability. Thus, clause 12 of the ICE Conditions of Contract for Design and Construct⁴ provides:

“If during the carrying out of the Works the Contractor encounters physical conditions (other than weather conditions or conditions due to weather conditions) or artificial obstructions which conditions or obstructions could not, in his opinion, reasonably have been foreseen by an experienced contractor, the Contractor shall as early as practicable give written notice to the Employer’s Representative.”

Given the origin of the FIDIC forms, it is not surprising that under FIDIC Red and Yellow Books, this traditional foreseeability test is also applied. Clause 4.10 of those FIDIC forms requires the Employer to have made available all relevant data in his possession on sub-surface conditions, not later than 28 days prior to the submission of the tender. Clause 4.11(b) then dictates that the Contractor is deemed to have based its Contract Price on such data. The Employer warrants the accuracy of the information he has provided and the Contractor is only responsible for interpreting the data. Further, under the FIDIC Red and Yellow Books the Contractor is deemed to have obtained all necessary information as to risks which may influence or affect his tender for the works. He is also deemed to have inspected and examined the site and other available information. However, these deeming provisions are limited in their application “to the extent” that the investigation by the Contractor is “practicable, taking into account cost and time.” This provides the Contractor with some basis for relief in the event its investigations (due to the constraints of available time and cost) do not reveal matters which subsequently manifest themselves in the form of sub-surface conditions different to those assumed when tendering and later entering into the contract.

On the allocation of risk for unforeseen ground conditions, the FIDIC Red and Yellow Books nevertheless broadly adopt the ICE clause 12 approach: the Employer carries the risk of physical conditions which could not have reasonably been foreseen by an experienced contractor at the date of tender.

The FIDIC Silver Book, in keeping with its turnkey approach to risk allocation, takes this one important step further. Whilst the Employer provides information to tendering contractors, it is the Contractor who is responsible for verifying as well as interpreting that data. There is no warranty by the Employer as to the sufficiency or completeness of the information provided. Under the FIDIC Silver Book, the risk of adverse physical conditions is intended to be allocated to the Contractor, who “accepts responsibility for having foreseen all difficulties and costs of successfully completing the Works.” Clause 4.12(c) provides a catch-all statement to ram home the point: “The Contract Price shall not be adjusted to take account of any unforeseen difficulties or costs.”

Contractors’ reactions to Silver Book risk transfer

It will not be surprising to learn that, in practice, these particular provisions of the Silver Book are commonly subject to heavy negotiation between the parties.

One device is simply to revert to the more traditional test of foreseeability so that the risk of the unforeseeable remains with the Employer. Another device is for the risk to be taken by the Contractor but only after it has had a reasonable opportunity to satisfy itself as to risks, contingencies and other circumstances concerning the site conditions. This is commonly undertaken during the FEED stage, where investigations and design development is undertaken on a reimbursable basis (i.e. paid for by the Employer), so that the Contractor can take an informed view as to the physical site conditions and arrive at a design, methodology, programme and a Contract Price for the works that is robust and reliable.

A further variant on this is to take the existence of ground condition reports and all the surveys and to use these to extrapolate assumed conditions which are then included as a benchmark under the contract. If variances are found in practice from the assumed conditions which affect time or cost, their impact may be allocated back to the Employer rather than retained by the Contractor.

Of course, the Contractor may also price the risk by including a sufficiently large contingency in the Contract Price. However, in a market where there is an excess of contracting capacity, with contractors chasing turnover and bidding prices at zero or negative margins, the likelihood of a winning bid containing an adequate risk allowance may be considered small.

Much depends on the relative bargaining power of the parties and, of course, the skill and experience of their advisers.

⁴ Second edition (September 2001) and officially withdrawn in August 2011, to be replaced by the new Infrastructure Conditions of Contract.

A recent decision on the FIDIC Yellow Book: *Obrascon*

A recent case involving a contract based upon FIDIC Yellow Book is illustrative of the issue as to foreseeability: *Obrascon Huarte Lain SA v Attorney General for Gibraltar* (2014).⁵ The judgment in the *Obrascon* case was delivered by Mr Justice Akenhead in the London TCC on 16 April 2014.

This dispute arose out of a contract entered into in December 2008 with a 24 month completion period and a Contract Price of some £30.2 million. However, some two years into a two year contract, the Contractor found itself two years late, with delay damages clocking up at a rate of £5,000 per day and having been paid only a third of the Contract Sum but with substantial running costs continuing. OHL forecasted that it needed nearly £80 million further to complete the job with further substantial costs for dewatering and decontamination of ground water and dealing with contaminated materials which it claimed were “*unexpected*” and “*not accounted for in the offer*”.⁶

The only road between Spain and Gibraltar crosses the airport runway. The road has to be closed when a plane lands. The works were intended to avoid this transport clash and ease congestion. The Employer required a new dual carriageway to be constructed, running along the eastern edge of the airport runway and a twin bore tunnel under one end of the runway in order to provide a route for traffic, thereby removing the transport clash with incoming and outgoing flights.

The illustrative design provided to tenderers delineated the route of the intended tunnels and included an environmental statement which contained advice as to the presence of contaminated material in the made ground. This made ground would have to be excavated as part of the works. The Contractor ultimately launched its claims (originally under the Contract and thereafter before the Court)⁷ for an extension of time and additional payment on the basis that it had encountered large quantities of contaminated ground and different types of rock which it had not reasonably foreseen at tender stage. These were said to amount to “*Unforeseeable*” physical conditions under Clause 4.12 of the FIDIC Yellow Book terms which had affected progress, caused delay and justified an increase in the cost of the works payable to the Contractor. The progress of the works had also been adversely impacted by heavy rainfall and the Contractor sought relief for this event too.

As noted above, FIDIC Red and Yellow (and even more so in the case of Silver) require the transfer of certain risks to the Contractor in respect of site conditions. In *Obrascon v Attorney General for Gibraltar*, it was necessary for the Court to apply the FIDIC definition of “*Unforeseeable*” in the Yellow Book. This is defined to mean “*not reasonably foreseeable by an experienced contractor by the date for submission of the Tender.*” The approach of the Judge is text-book stuff but a salutary reminder because, as *Obrascon* illustrates, contractors may sometimes be suspected of having underestimated the extent of site risks and thereby bid a Contract Price that is inadequate for the extent of the works required to complete the project.

Application of the foreseeability test

In relation to the application of the foreseeability test, the Judge said some interesting things which contractors (whether under FIDIC or other forms of construction contract with similar tests) would be well advised to consider.

Thus and in relation to contamination reports and related data provided to the tendering contractors: “*I am wholly satisfied that an experienced contractor at tender stage would not simply limit itself to an analysis of the geotechnical information contained in the pre-contract site investigation report and sampling exercise.*” The Judge went on to “*adopt what seems to me to be simple common sense by any contractor in this field*” when contemplating the presence of contaminants (as a result of use over many years) in made ground which had to be removed (and disposed of) as part of the works.⁸

Further, in reviewing the particular site characteristics in Gibraltar, the Judge said this: “*Tendering contractors must and should have known and appreciated that historically, the site had been influenced environmentally by its military use (over hundreds of*

⁵ *Obrascon Huarte Lain SA v Attorney General for Gibraltar* [2014] EWHC 1028 (TCC).

⁶ Paragraph 109 of the Judgment.

⁷ The proceedings were commenced in the High Court in Gibraltar but the parties subsequently agreed to transfer these to the specialist Technology and Construction Court within the High Court in London.

⁸ Paragraph 215 of the Judgment.

years) which could be a source of contamination from heavy metals and trace elements and by its use as an airport area, where it would be expected that evidence of the presence of hydrocarbons and related derivatives would be found ... the ES⁹ contained reference to the history and various historical maps and ... actually showed the precise position of earthwork rifle butts in 1869 pretty well along the line of the tunnel and adjacent ramps ... it must have been obvious to anyone who applied any real thought to this that the residues of what soldiers had been firing with on these rifle ranges would include the lead in the bullets or musket balls likely to have been used. Those butts had obviously been levelled years before 2007; thus foreseeably there would have been lead spread around the area within the made ground.”¹⁰

In other words, contractors are not limited to reviewing only the data that the Employer makes available. Rather, when assessing what is “reasonably foreseeable by an experienced contractor” the law expects the contractor to read around the subject and use its own experience and common sense. However, the Judge found on the evidence that “OHL did not in fact anticipate, expect or in practice plan for encountering any significant quantities of contaminated materials at all”.¹¹

Further and where empirical data is supplied, contractors are expected to review this intelligently. In *Obrascon*, the ITT included a requirement that tenderers should allow for 10,000m³ of contaminated material. This led to the Judge to conclude “in my judgment any experienced contractor tendering for the road and tunnel works would foresee that there would or at least could realistically be substantial quantities of contaminated material.” He went on to find that the 10,000m³ figure “was hardly anything more than a ‘say’ figure and is in effect a warning to tendering contractors that a sizable amount of contaminated ground should be anticipated.”¹²

The judgment is also interesting in what it says about the reliability of expert evidence where the data issued at tender stage is itself only a sample. That information included a contamination report which was based on a series of boreholes which revealed a wide variety of depths at which contamination was present in the made ground. However, the Judge found that the expert evidence which sought to extrapolate from or interpolate between the samples to produce an assessment as to the amount of such contamination was “no more than guesswork and essentially unreliable”.¹³

As the learned Judge noted, it might be different if excessive quantities of hydrocarbons were found at the same depth over say ten samples within a 400m² area; that might allow for a reliable extrapolation/interpolation exercise to be carried out. Similarly, it might be easier to draw conclusions from a series of Standard Penetration Tests as to the likely strength of rock. However, the results of the contamination sampling within the made ground showed a much more random distribution, which meant that a definitive conclusion as to the likely amount of contamination was not available. In such circumstances, prudent contractors should allow for more, not less, quantities of potentially contaminated material.

What should the contractors do to address the risks they ought reasonably to foresee?

The Judge also provided some guidance as to how a contractor in OHL’s position should have addressed the foreseeable risk of contamination. Whilst each case turns on its own facts, it is suggested that the steps recommended by the Judge are more likely than not to be applicable in the majority of similar cases. Based on the evidence provided to tendering contractors in *Obrascon*, the Judge suggested that OHL could reasonably have done all or some of the following:

Make a substantial financial allowance within the tendered price for dealing with what was likely to be a large quantity of contaminated material;

Plan and price for a post-contract site investigation including further trial pits and testing in order to build up a picture of where there was contamination, then establish a working method on how to remove it and what to do with it;

9 Environmental Survey report issued to all tendering contractors.

10 Paragraph 215 of the Judgment.

11 Paragraph 224 of the Judgment.

12 Paragraph 219 of the Judgment.

13 See paragraph 220 of the Judgment.

Plan to remove all the made ground as having a good chance of containing contaminants; and

Plan the design and method of construction to allow for randomly distributed quantities of significant contaminants in the made ground.

Ultimately, in *Obrascon* the Judge found that the Contractor did not in fact encounter physical conditions in relation to contaminated material over and above that which an experienced contractor could reasonably have foreseen by the date of submission of its tender. It followed that the contractor's claim for "Unforeseeable" physical conditions failed in relation to the contamination. The Judge made a similar finding in relation to the extent of contaminated ground water.

OHL also encountered rock (when excavating for the diaphragm wall panels) at higher levels than it said an experienced contractor at tender stage could reasonably have foreseen. As a result it had to adopt a different and more time consuming costly working method to excavate through the rock. Here, the Contractor was partially successful, with the Judge assessing that "experienced contractors could not reasonably have foreseen 500m³ of the hard material or rock that would need chiselling"¹⁴ and allowed this quantity as being unforeseeable. It might be noted that this was against the Employer's expert evidence to the effect that over 4000m³ was foreseeable.

FIDIC, Contractors' claims and conditions precedent

There is one particular clause in FIDIC forms which strikes fear into the heart of even the most well organised contractor, namely the condition precedent that must be satisfied in order to recover against what otherwise may be an entirely meritorious claim.

Clause 20.1 of FIDIC Red, Yellow and Silver Books is in the same terms and provides that if the Contractor considers it is entitled to an extension of time and/or any additional payment, it is required to give notice "describing the event or circumstance giving rise to the claim as soon as practicable, and not later than 28 days after the Contractor became aware, or should have become aware, of the event or circumstances". Clause 20.1 goes on to provide that if the Contractor fails to give such notice then time is not extended, neither is he entitled to additional payment and the Employer is discharged from liability. In the *Obrascon* case, it was accepted by Counsel for the Contractor that Clause 20.1 imposes a condition precedent to entitlement which must be satisfied if the claim is to be successfully advanced.

This is an important judgment from a well-respected senior TCC Judge on a FIDIC provision which Contractors and Employers frequently fight over.¹⁵

The Judge found that there was no prescribed form for giving notice under Clause 20.1. Thus, email correspondence, minutes of meetings and other written records could, in principle, suffice as notice provided it was clear what was being notified. However, the Judge made clear (and *Obrascon* is now authority for the proposition) that in order to constitute a valid notice under Clause 20.1 of the FIDIC Yellow Book form, the notice must be in writing, must be clear that the contractor intends to notify a claim and must describe the event or circumstance relied upon.

Clause 20.1 is in materially similar terms under FIDIC Silver, Yellow and Red Books¹⁶. This case is therefore of wider application when it comes to considering whether notice of a contractor's claim has been validly communicated. However, FIDIC's Gold Book, published in 2008, requires notices to comply with certain express requirements including being "identified as a Notice and include reference to the Clause under which it is issued"¹⁷. The *Obrascon* case may encourage parties to tighten up the drafting of their FIDIC-based contracts when using Silver, Yellow or Red Books, adopting some of the drafting clarifications found with the Gold Book.

¹⁴ Paragraph 270 of the Judgment.

¹⁵ Similar condition precedent language is also found in NEC 3 contracts.

¹⁶ Save that under Silver, notice is given to the Employer as there is no Engineer (unlike under Red and Yellow Books).

¹⁷ Gold Book, Clause 1.3

Pulling the trigger under Clause 20.1 notifications

Interestingly, in relation to the operation of Clause 20.1 for claims for extensions of time, in *Obrascon* the Judge went back to the source of such entitlement which is to be found in the wording of Clause 8.4 of the FIDIC form. This provides that “*the Contractor shall be entitled... to an extension of the Time for Completion if and to the extent that the Completion... is or will be delayed by any of the following causes...*”. The Judge seized on the words “*is or will be delayed*” and noted that the “*event or circumstances giving rise to the claim*” could arise either when it was clear there will be a delay (a prospective delay) or when the delay had been at least started to be incurred (a retrospective delay). This led to a more generous time scale for the Contractor to notify the delay.

However and importantly, this runs counter to the requirement in Clause 20.1 for the Contractor to give notice within 28 days after it “*became aware, or should have become aware, of the event or circumstance*”. If the Contractor ought to know that completion “*will be delayed*” by some event, then Clause 20.1 says it should notify within 28 days and if it fails to do so, it forfeits its right to an extension of time. However, according to the logic applied by Mr Justice Akenhead in *Obrascon*, the Contractor has the option of postponing notification until such time as the effect of the delay “*is*” occurring. Whilst it should be recognised that Clause 8.4 deals with matters of entitlement whereas Clause 20.1 is concerned with the requirement to give a notice of any claim, Clause 8.4 nevertheless refers to such entitlement being “*subject to Sub-Clause 20.1*” which indicates that the claim notification requirements under Clause 20.1 are intended to prevail. Thus, the Judge’s finding as to the operation of Clause 8.4 of the FIDIC Yellow Book (which is identical in the Red and Silver Books) may be regarded as controversial. All that said, the Judge’s reasoning is hard to fault. As he pointed out:

“*The wording in Clause 8.4 is not: ‘is or will be delayed whichever is the earliest’*” (my emphasis).

Of course, *Obrascon* is a decision of the English High Court, decided under English law and therefore applies English common law principles. It may not necessarily be followed in other jurisdictions.

In any event, applying these requirements in relation to the weather delay claim, even though as a matter of fact the Judge found that six days delay was caused by the impact of rainfall, the Judge also found that the notice relied upon by the Contractor did not in fact describe “*the event or circumstance giving rise to the claim*” but referred to a future effect of rainfall on the contaminated material on site, rather than the effect of the rain as it fell. Harsh as it may seem, this notice was found not to comply with the requirements of Clause 20.1 and the weather delay claim therefore failed.

Termination

The *Obrascon* contract (following the standard FIDIC text) said it could be terminated for failure by the contractor to comply with a notice requiring it to remedy a failure to carry out “*any obligation*” under the contract. But what if an unremedied breach is trivial? Does the termination option still apply?

The court noted that “*Hudson’s Building and Engineering Contracts*” (12th Edition) had correctly stated that determination clauses such as the one in question will generally be construed as permitting termination for significant or substantial breaches, as opposed to trivial, insignificant or insubstantial ones. That accorded with commercial common sense. The parties could not sensibly have thought (objectively) that a trivial contractual failure could lead to contractual termination. One day’s culpable delay on a 730 day contract or 1m² of defective paintwork out of 10,000m² good paintwork would not, for reasonable and sensible commercial people, justify termination, even if the contractor did not comply with a notice to remedy. On the other hand, the breach did not have to be repudiatory. What is trivial and what is significant or serious will depend on the facts.

This issue is likely to be relevant for Contractors engaged under FIDIC forms of contract. It is also likely to be relevant where Contractors are engaged on terms where the contract provides for specific remedies, for breach say of an obligation to comply with the specification and with a termination right applicable after a long-stop date, as may be encountered under many bespoke EPC contracts. This case is consistent with other judicial guidance to the effect that the remedy has to be proportionate to the damage.

Some concluding remarks on the impact of *Obrascon*

The default position for dispute resolution under FIDIC contract forms calls for arbitration as the ultimate forum for dispute resolution. As FIDIC is often used on overseas projects between parties of different nationalities, international arbitration is also seen as preferable to litigating disputes in the local courts, avoiding issues as to quality of the local tribunal as well as issue of enforceability.¹⁸ It is therefore unsurprising that there are not many publicly decided cases on FIDIC forms of contract. The *Obrascon* case merits a read if only for this reason alone.

However, *Obrascon* is also of interest because it illustrates the practical application of the foreseeability test. This is likely to impact in cases where it is considered the contractor has not taken proper care during tender stage to evaluate site risks and build these into his design, working methodologies, programme and pricing. Where the terms of the Contract allocate such risks to the Contractor, up to the extent of reasonable foreseeability, it is perhaps an obvious point (albeit one seemingly ignored by the contractor in this case) that some careful thought needs to be given to identifying and pricing site risk. In the words of the Judge in the *Obrascon* case: *“It is difficult to avoid the conclusion that OHL knew that there was going to be some contamination but hoped to avoid having to do anything about it”*.¹⁹ If ever there was a salutary warning for contractors, this is it.

The judgment in *Obrascon* also emphasises that under English law, non-compliance with Clause 20.1 notice requirements in the FIDIC suite of contracts precludes a Contractor from pursuing what might otherwise be a valid claim.²⁰ This may encourage closer adherence to such provisions in jurisdictions where Clause 20.1 may be regarded as having a similar effect.

Finally, *Obrascon* provides a new (and potentially controversial) approach as regards the notification of Contractors' claims for an extension of the Time for Completion under the FIDIC suite of contracts. Whilst Clause 20.1 states that notice of any such claim should be given within 28 days of the date when the Contractor becomes aware, or should have become aware of the event giving rise to the right to claim, Clause 8.4 only requires notice from the date when the effect of the delay is actually experienced, which could be later than the time limit contemplated by Clause 20.1. As the extension of time claims of Contractors often entail substantial sums of money, this point is of more than mere academic interest.

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¹⁸ If the host states of the contracting parties have ratified the 1958 New York Convention on the Recognition and Enforcement of Arbitral Awards, the award should be enforced through the local court.

¹⁹ Paragraph 55 of the Judgment

²⁰ FIDIC Gold Book moderates this draconian impact by conferring upon the DAB jurisdiction to overrule the 28 day limit where it finds that the reason for late notification was “fair and reasonable”.

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