

Coronavirus in the Construction Industry – An Insight into Maintaining Contractual Certainty in Uncertain Times

The ongoing outbreak of COVID-19 threatens to stall the progress of construction projects across the UK. This is because live construction sites face possible disruptions due to unhealthy workers or government-imposed policies aimed at reducing public interaction to limit the outbreak. Depending on the level of disruption caused and the terms of the underlying contracts, contractors are likely to claim for extensions of time. Some contractors may also wish to claim for loss and expense. However, the efficacy of such claims will be dependent on the construction contracts entered into. For this reason, it is important that you understand the applicable terms of your specific contracts and appreciate that they may be subject to adaptation. In the paragraphs following, we identify two of the more popularly used standard form construction contracts (JCT Contracts and NEC Contracts) and interpret them in light of COVID-19 related concerns.

Background

As the construction industry grapples with the COVID-19 outbreak, there is increasing concern among our Clients and key industry contacts about construction operations. The UK government is encouraging social isolation and has currently implemented a nationwide lockdown with people only allowed to leave home for limited reasons and expected to maintain a 2 metre distance from each other. The government has caveated that workers may travel to work if they cannot work from home, therefore allowing construction workers to continue working provided they maintain a 2 metre distance from each other. Outside the UK, the governments of countries such as Italy, France, Belgium and Spain have enforced mandatory restrictions on movement within and across their borders, the EU has closed its external borders to non-EU states and the US has closed its borders to all European Nations. The UK government has maintained that its policies will remain under constant review. It is therefore likely that the UK government may enforce stricter policies to combat the virus in the near future.

From a legal context, a major concern is whether the virus outbreak falls within the scope of a “force majeure” event in the underlying contract. If the answer to this is in the affirmative, then performance of the contract may be impossible, and parties may be released from their contractual obligations and entitled to terminate the contract.

The Government has since enacted the Health Protection (Coronavirus) Regulations in England, granting the Secretary of State special powers to implement limitations on people from infected areas. It is anticipated that further legislation may follow shortly. Should the UK government take more restrictive action, contractual terms covering changes in law and the exercise of statutory powers may be applicable.

In the commentary that follows below, we review the position in two of the more popularly used standard form commercial contracts in the UK as well as contracts which do not include force majeure clauses. Our analysis will focus only on contracts governed by English Law. Our analysis will also focus largely on the forms of the main contract. However, in the majority of cases, the same position will overlap with the relevant sub-contract forms. It is important to note that these standard forms are often amended meaning that entitlements to loss and expense and extensions of time will vary.

JCT Contracts

Force Majeure

- Force Majeure is a Relevant Event under Clause 2.26.14 of the JCT 2016 contracts thus giving Contractors a potential entitlement to an extension of time.
- Force Majeure is not a defined term under the JCT 2016 Contracts and presently has no standardised meaning in English Law. It is commonly used in contracts to cover unforeseeable circumstances that prevent a party from fulfilling contractual obligations. Each circumstance will be assessed based its facts and whether the circumstance in question actually prevented performance. There is currently no case law concerning what constitutes force majeure under the JCT contracts. However, it has been suggested that force majeure should be interpreted narrowly given that other Relevant Events under the JCT expressly cover circumstances such as weather, strikes, fire, war and Government action. There is likely to be a rise in the number of cases contesting the interpretation of force majeure and Relevant Events post COVID-19.
- Occasionally, in amended JCT standard forms, the force majeure and/or Relevant Events clause is amended to ensure that only a limited list of specified examples such as nuclear contamination, volcanic eruptions and other unlikely phenomena are covered. Some contracts will also include 'biological contamination.' However, there is likely to be disagreement over whether the parties intended a virus such as COVID-19 to be covered by such a term.

Changes in Law

- Clause 26.16.12 of the JCT Contracts 2016 states that the 'exercise of statutory powers by the Government of the United Kingdom or any Local or Public Authority' after a specified date, which is usually the date of the Contract or the date of the Contractor's Tender, is a Relevant Event. So far, the UK government has implemented a nationwide lockdown with people only allowed to leave home for limited reasons and expected to maintain a 2 metre distance from each other. The government has allowed the construction industry to continue to work provided workers maintain a 2 metre distance from each other. The government has also stated that its policies will remain under constant review. It is therefore possible that even stricter measures may be imposed.
- It is worth noting that this Relevant Event is often amended to exclude circumstances where changes in law were 'reasonably foreseeable' at the time the contract was entered into. With respect to COVID-19, the foreseeability of changes in law is likely to be a matter of timing. Prior to January, it may not have been reasonable to foresee strong government intervention/legislation, however changes in law are now an immediate possibility.

Relief Under JCT Contracts

- Relevant Events that disrupt works may give rise to an extension of time and consequently, relief from liquidated damages. Relevant Events, however, do not grant any protection for any loss and/or expense that a contractor suffers. Such loss/expense is only recoverable if the circumstances from which they arise are also a Relevant Matter under the contract. None of the previously mentioned Relevant Events are also Relevant Matters and COVID-19 itself does not technically fall within the scope of any other Relevant Matter under the standard form JCT contracts. Contrastingly, COVID-19 could give rise to acts of prevention such as delayed designs or instructions, which could amount to Relevant Matters and merit claims for loss and/or expense.
- Clause 2.24 of the JCT 2016 Contracts outline a formal procedure that must be followed in notifying and judging entitlement to extensions of time.

- Under Clause 8.11, both the previously mentioned Relevant Events are also potential termination events provided that they prevent the whole or substantially the whole of the unfinished works from being completed for a specified period agreed by the parties. The standard specified period is two months however parties often amend this.
- It is important that Contractors are aware that Clause 2.25.6.1 places them under a constant duty to use best endeavors to prevent any delays regardless of how they originate.

NEC Contracts

Force Majeure

- Force Majeure is also not a defined term in the NEC Suite. The NEC 'prevention' criteria as outlined in Clauses 19.1, 60.1(19) and 91.7 contain set criteria that determine whether a given circumstance amounts to a force majeure event and is consequently covered by a force majeure provision.
- The three criteria that must be satisfied under the NEC engineering and construction contract can be summarised as follows:
 - The event in question must have prevented the Contractor from finishing the works or caused a delay (by reference to the Accepted Programme);
 - neither party could have prevented it; and
 - as at the Contract Date an experienced Contractor would have judged there would have been such a small chance of the event happening such that it would have been unreasonable for the experienced Contractor to allow provision for it.
- These criteria are stringent and often difficult to satisfy in practice. The provisions are also often removed or amended from NEC Contracts. If all three limbs are satisfied, then the event would also be a compensation event under the NEC Contract thus meriting claims for both money and time extensions.

Change in Law

- While an exercise of statutory powers or a change in law could satisfy the above 'prevention' criteria, there is also a clause which can be opted into under the NEC Contracts (Option X2), which renders a change in law after the Contract Date a compensation event. This will be applicable should the UK Government enact mandatory restrictive legislation that prevents construction works from being completed. Option X2 is an optional provision therefore the NEC Contract must expressly state that Option X2 applies.
- Option X2 is also often amended to exclude circumstances in which the change in laws are reasonably foreseeable. As mentioned in the preceding paragraphs on JCT contracts, changes in law were not reasonably foreseeable prior to January. However, they are now an immediate possibility.

Procedure for Relief

- Under Clause 15.1 a Contractor is required to issue an early warning notice.
- Under Clause 61.3, a Contractor must notify a Project Manager of any compensation event within eight weeks of the Contractor being aware that the event has taken place. Failing to do so will result in loss of entitlement to time and/or money.
- Under Clause 91.7 of the NEC, only a Client/Employer may terminate a contract if a force majeure event is estimated to delay completion of the works by more than 13 weeks. The NEC also makes provision for both a Contractor and/or Client/Employer to terminate a contract if the parties have been released from carrying out the contract by law. However, it may be

difficult for parties to rely on this as an all-encompassing right to terminate in situations where laws only temporarily affect the performance of the contract.

Contracts Without Force Majeure Clauses

Where contracts do not include force majeure clauses, the doctrine of frustration may apply where unforeseen events prevent performance of the contract. It is important for Clients to understand how the doctrine operates, as it may allow clients to exit contracts without facing any penalty.

The Doctrine of Frustration

The doctrine of frustration applies such that a contract may be discharged on grounds of frustration where a circumstance arises after the formation of the contract which either makes it physically or commercially impossible to complete the contract or changes the obligation to carry out the contract to a substantially different obligation from the obligation envisaged by the contract at its entry. The arising circumstance must go to the very root of the contract and neither party to the contract must be at fault. Once a frustration event arises, the contract is terminated by the operation of law without any further action necessary from the parties. The test to establish frustration is an objective one and will be considered in light of:

- the contract terms;
- the circumstances in which the terms were agreed;
- the assumptions and expectations of the parties;
- the nature of frustrating event; and
- the parties' intentions in new circumstances.

With regards to frustration, the contract terms will always be the starting point. Certain terms which determine what is to happen if circumstances arise that prevent, or delay performance may also prevent a contract from being frustrated. For such terms to prevent the contract being frustrated they must both cover the arising circumstance in question and make complete provision for subsequent issues arising. If such clauses exist then, the contract remains intact in so far as it not illegal for the contract to remain in force (either because the Government enforces stricter restrictions on workers movement or outright prohibits the works from taking place). Delay and price-alteration clauses must be considered carefully in this light. The following scenarios are provided to further illustrate this:

A agrees to provide B with catering services for a construction project of a building scheduled to complete in 2020. The construction is postponed due to the pandemic. The contract to provide catering services also provides that in the event of a cancellation/postponement of the construction for whatever reason A and B agree that catering services will be provided at the re-arranged date or, if there is no re-arranged date, the re-commencement of construction in 2021.

Here, the contract has not been frustrated because the parties have agreed how to address a cancellation of the event and the allocation of risk in that regard.

A agrees to provide B with specified materials for a building project including assembly and delivery of certain materials. The contract provides that in the event that, due to whatever reason, A is not able to provide any part of the agreed package the contract will continue in respect of the remainder of the package with a proportionate reduction in price. Due to the pandemic A acquires and can deliver the materials but is unable to assemble some materials as it has insufficient healthy staff with the specialist know-how to do so.

Here, the contract terms would be insufficient to avoid frustration because they do not make complete provision for all issues arising and only excuse A from the consequences of what would otherwise be a breach of contract.

As with the previously mentioned standard contracts, the doctrine of frustration will not apply if parties enter into a contract at a time when they foresee that a circumstance (in this case the pandemic) might impact on the performance of the contract in the future, even if they do not contractually provide for what is to happen.

Other Relevant Scenarios Regarding Frustration

Difficulty arises in situations where there is both a clear contractual provision for what is to happen and supervening illegality. The following examples are provided to further demonstrate this:

A and B's construction project is postponed as several workers on the construction site test positive for the virus and the building work on the project is consequently prohibited indefinitely by the Government. A and B have various contracts with other businesses to provide goods and services for the construction project.

Whether those contracts are frustrated will depend upon the contract and its foundation, together with the reason the contract cannot be performed. A contract to deliver building materials in this scenario may not be frustrated considering that the circumstances that had led to the cancellation of the project do not affect the performance by the manufacturers. Unless in the unlikely event the delivery contract was founded on the construction proceeding – the construction not proceeding does not prevent the preparation and delivery of the materials.

A is an independent surveyor retained by B for a limited period of 3 months (by reference to specific dates) to provide services at B's premises. A is a vulnerable person and is advised to self-isolate for 3 months such that the contract cannot be performed.

Here the contract would be frustrated because it cannot be completed for reasons out of A's control. It is highly unlikely that a Court would find that there was a possibility of performance where performance would be contrary to Government advice and at risk to the health and life of A.

A is manufacturing and delivering specified materials to B at a fixed price of £200,000 for a specified date 6 months later. Due to the pandemic A loses 60% of its workforce with the result that the contract costs it £100,000 over its agreed budget and causes it to be late in delivering the product. A wants to treat the contract as frustrated.

Here the contract would not be frustrated as it was still capable of performance despite more onerously and at greater cost than previously envisaged.

Consequences of Frustration

Once a frustration event occurs, English law provides that the parties to a contract are automatically discharged from their obligations under the contract. The Law Reform (Frustrated Contracts) Act 1943 sets out the recovery of monies paid and compensation for any valuable benefit provided before the frustrating event. However, frustration may not always be a commercially viable option for parties. With the current virus outbreak for example, some contracts may be for very long durations and may also contain clauses which remain possible to complete despite the temporary effects of the outbreak. A wrongful reliance on frustration could prompt an aggrieved party to a contract to claim anticipatory or repudiatory breach that could lead to the termination of the contract and exposure to a claim for damages against the party seeking frustration.

While our clients and industry contacts are justifiably concerned about extensions of time and cost consequences as a result of the COVID-19 outbreak, attention must also be given to security and/or health and safety clauses in your specific contracts. Most construction contracts will include clauses that require a Contractor not to abandon the construction site, maintain security and uphold health and safety standards. Parties must consider what steps need to be taken to fulfill these obligations.

Recommendations

The consequences of the virus outbreak will be significant, and it is likely that Government intervention will ultimately be necessary to assist the construction industry as a whole. As we learnt from the Carillion saga a few years ago, contractual rights are meaningless if parties are financially incapable of bearing the consequences of a breach. That being said, the standard forms discussed above may provide relief for breakdowns in contractual performance relating to COVID-19, albeit with different risk balances. Under both JCT and NEC contracts there is a reasonable possibility that COVID-19 will create “force majeure” events that will result in extensions of time. The position on loss and expense will vary depending on the wordings of the specific contracts, however in most situations a contractor will be able to claim in respect of prevention of works caused by its agents or employer as a result of COVID-19. In the absence of a force majeure clause, the doctrine of frustration may apply to terminate contracts which are incapable of completion as a result of an unforeseen frustrating event. Whether a contract will indeed be frustrated will depend on the specific facts surrounding the contract. While the test for establishing frustration often carries a high threshold, many contracts may well be frustrated given the current nationwide lockdown. We recommend taking the following steps in relation to force majeure and frustrating events:

- review the terms of your specific contract, particularly any protocol for serving notices, termination rights and the parties’ duties under the contract to mitigate loss (whether to use reasonable best endeavors or a standard above or below this);
- maintain a solid record of evidence supporting (or refuting) claims for extensions of time and/or money; and finally
- consider negotiated solutions where possible.

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