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Caught by the Virus

What Are the COVID-19 Effects on Your Construction Contract?

Impact of COVID-19 on Construction Contracts

The coronavirus disease 2019 (COVID-19) has caused, and will continue to cause, significant disruption to the construction industry. Its effects will likely result in delay, cost overruns, changes in the schedule of the works and, in extreme cases, total prevention of performance.

Parties to a construction contract should immediately consider whether the impact of COVID-19 could be mitigated by contract and other legal mechanisms, such as:

- *Force majeure* clauses
- Extension of time (EOT) and suspension clauses
- Change in law clauses
- Frustration

Force Majeure

What Is a Force Majeure Clause?

A typical *force majeure* clause seeks to exclude the liability of one or more parties for events beyond their reasonable control. In Australia, *force majeure* clauses are not implied into contracts and must be specifically expressed and defined. As a result, any protection will vary from contract to contract.

In general, *force majeure* clauses will usually:

- Define what constitutes a "*force majeure* event"
- Oblige a party affected by a *force majeure* event to notify the other party that a *force majeure* event has occurred
- Suspend the affected party's obligations under the contract to the extent affected
- Give rise to certain rights and remedies

Could Force Majeure Apply to COVID-19?

First, parties must examine their contract and determine if it has a *force majeure* clause. Parties should not assume that there is a *force majeure* clause. For example, the commonly used Australian Standard form general conditions for construction contracts (AS2124 and AS4000) do not contain specific *force majeure* clauses.

If the contract does contain a *force majeure* clause, one must then consider the actual "event" preventing performance. Is it:

- The virus itself (e.g. the workforce is unwell and unable to work)
- The government enforced shutdown
- A company's own internal precautionary measures?

Next, parties must determine if the event falls within the definition of *force majeure*. Contracts generally define it in one of two ways; either by reference to an exhaustive list of specific events or by reference to a general description of the event.

An exhaustive list of events may include events such as extreme weather, acts of war, terrorism, political unrest, governmental actions, epidemics and other events that might make performance impossible or impracticable. Where a contract has an exhaustive list of specific events that does not include disease, epidemics or government action, COVID-19 may not amount to a *force majeure* event.

It is more likely that COVID-19 would fall within a definition that provides a general description. For example, under one international standard form of contract, *force majeure* is defined as an "Exceptional Event" that:

- Is beyond a party's control
- The party could not reasonably have provided against before entering into the contract
- Having arisen, such party could not reasonably have avoided or overcome
- Is not substantially attributable to the other party

If such an event occurs, parties may be entitled to an EOT, provided that they are prevented from performing any of their contractual obligations because of the Exceptional Event and they have complied with the contractual notice requirements.

Whether a disruption arising out of COVID-19 amounts to a *force majeure* will likely depend on all the circumstances of the claimed disruption.

Process for Enlivening Force Majeure

Many *force majeure* provisions require the party seeking protection to follow a prescribed process. This process will often require serving a notice within a strict time period.

For example, a party may be required to notify the other party within seven days of the first occurrence of that event. If the World Health Organisation's classification of COVID-19 as a pandemic on 12 March 2020 is relied on as the first occurrence, then notice must be given to the other party by 19 March 2020. A party's failure to follow such a process could leave it exposed to non-performance and associated time and cost risks.

Consequences of Activating a Force Majeure Clause

Before evoking a *force majeure* clause, parties should consider its consequences, which will differ between contracts. They are not necessarily limited to excluding performance – they often trigger rights and remedies for the other party. This may include a right to terminate if the event is prolonged.

Therefore, it is important to consider the full consequences as they may outweigh the immediate benefits.

Force majeure clauses are typically evoked because of specific events that affect only one party (e.g. warehouse burns down). However, the COVID-19 pandemic has significantly impacted businesses at every stage of the supply chain. If you are affected, you may find that the other party is too, and is willing to adopt a "we are in this together" mindset to formulate a solution. A negotiated outcome may achieve an all-round better outcome.

Extension of Time and Suspension Clauses

EOT clauses should be carefully reviewed as the availability and scope of these clauses varies from contract to contract. For example, AS 2124 allows an EOT where the Contractor is, or will be, delayed by events occurring on or before the Date for Practical Completion that are beyond the reasonable control of the Contractor (cl 35.5 AS 2124). In contrast, the availability of an EOT under AS 4000 is far more limited and does not include "events beyond the control of the contractor".

EOT clauses usually contain strict time and form requirements for notification to the other party. Failure to comply with these requirements may jeopardise a party's EOT claim.

COVID-19 may cause circumstances to occur that result in a direction to suspend work. Care should be taken in considering the exercise of suspension rights given most contracts allow for compensation to the contractor for the extra costs of suspension.

Change in Law Clauses

Construction contracts will generally provide for how to deal with the effects of any changes in law. Significantly, they may determine who is responsible for the costs associated with complying with changes in law. The effect and content of these clauses vary from contract to contract.

In order to curb the spread of COVID-19, governments have instituted sweeping changes in law. These changes may impact on a contractor's ability to complete work in a manner that does not contravene the law or on an owner's ability to perform its obligations, such as granting access.

Parties should review their contracts to determine what rights or liabilities exist under a change in law clause. The key issues that should be considered if there is a change in law clause are:

- What constitutes a "change in law"?
- Who is responsible for the costs arising from complying with changes in law?
- What is the outcome of the impact of the change in law?
- What process, if any, needs to be complied with?

The final point is of particular importance. Like *force majeure* clauses and EOT clauses, it is critical that parties comply with the contractually prescribed processes to ensure that they are adequately protected.

Frustration

Frustration arises when circumstances occur, by no fault of either party, which result in the obligations under the contract becoming incapable of being performed.

Whether or not a contract has been frustrated depends on the contract and the effect the frustrating event has on the ability of the parties to perform their obligations. Delay or increased difficulty do not amount to frustration. The circumstances must make obligations under the contract impossible or radically different. For example, if performing the contract would result in a breach of new quarantine or social distancing laws arising out of COVID-19, this may raise the prospect of frustration.

Parties should not rely upon frustration without careful consideration of its effects. This is because if a contract is frustrated, the contract is terminated, not suspended, which may not be a desirable result.

Conclusion

As COVID-19 continues to disrupt the construction industry, parties should be particularly aware of any *force majeure*, EOT, suspension or change in law clauses in their contracts, which may alleviate risk or protect a party's position. However, as these clauses vary from contract to contract and strict compliance is generally required to properly protect a party's interests, it is essential that construction contracts, supply contracts and subcontracts, as well as the background facts, are examined carefully, and all consequences and aspects are considered.

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