

COVID-19: Is your construction contract prepared for the disease?

March 19, 2020

Communities—big and small—are trying to adapt to the spread of COVID-19. You are perhaps reading this at home ...

“How will our construction project be affected?”

“What if the masks reserved for concrete mixers are commandeered for use by the local hospital?”

The situation is evolving daily and the final consequences remain hard to predict. Construction projects connect many economic participants, locally and abroad, and reports already indicate that the global supply chain will take months to recover from the current strain on the system.

A logical assumption is that COVID-19 is a force majeure, also known as an Act of God. Much has been written about force majeure and contracts just in the last week. Dentons’ global website already includes a couple of articles from our own colleagues on this topic¹. We do not propose to repeat general guidance based on the way courts have interpreted the concept of force majeure. Instead, we offer the below checklist of key elements to consider when reviewing force majeure clauses in your contracts.

Read the contract

Whether the COVID-19 pandemic amounts to a force majeure depends on the language of the contract. A force majeure clause excuses a delayed party from meeting its scheduled obligations to the extent affected by the force majeure event.

Some contracts are completely silent on force majeure. Silence will not automatically mean there are no force majeure rights. The context of the entire contract may support a claim where no express right to relief is written, but implied rights will at best be limited. The common law doctrines of impossibility and frustration of purpose may be useful to parties who breach their contractual obligations as a result of COVID-19 or its knock-on effects. Over the years, Canadian courts have relied on such doctrines to excuse performance by a party where a supervening event prevented it from performing its part of the agreement. However, courts have historically applied these doctrines narrowly, and not where a party is simply inconvenienced or faces hardship. Prudent parties will therefore want to take all reasonable steps to complete their obligations, even in the face of increased inconvenience and additional cost. We will likely see new law as COVID-19 cases work their way through the courts.

Depending on the circumstances and the terms of the contract, the effects of COVID-19 may allow a party to invoke different rights to relief and compensation. For example, as governments begin ordering protective measures that go beyond voluntary social distancing, contractors may become unable to maintain previous levels of site activity. Such mandatory restrictions could trigger the change in law provisions of a contract, typically entitling the contractor to both

schedule and cost relief.

Parties will also want to be careful when exchanging correspondence regarding COVID-19, so as not to inadvertently amend or waive contractual requirements. Failure to insist on contractual rights can be considered a waiver of those rights. Too much informality creates the argument (commonly made, in our experience) that the parties, by their actions, amended the contract, or that one party waived its right to insist on strict compliance with the contract. That said, we anticipate that, for many contracts, fundamental assumptions about schedule and risk have been shifted by the response to the pandemic. It may be appropriate and necessary to find a compromise position – without prejudice to either party’s right to later re-examine any modified allocation of risk agreed on an interim basis – to keep a project moving forward in the near term.

1. *Definition of force majeure*

- a. Some contracts do not define the events that constitute force majeure, and instead rely on generally accepted definitions of the term, including the concept of Act of God. In the current context, COVID-19 will likely be accepted as a force majeure event.
- b. Even when a contract defines force majeure, the definition does not always explicitly include pandemic, epidemic or quarantine among the usual list of examples. Keep in mind that such lists of examples are usually non-exhaustive. Regardless of the breadth of examples, it should be possible to claim the existence of a force majeure if the objective criteria in the definition are actually met.
- c. Such objective criteria typically require that the event be beyond the reasonable control of the affected party, and that the event actually impede or delay performance by the affected party. Some clauses go further and require that the event not have been foreseeable by the affected party when it entered into the contract. Other clauses will set geographic boundaries around qualifying force majeure events, e.g., an event will only be considered a force majeure if it happens in the country where the project is being built. Obviously, such geographic limitations can be challenging for contractors dealing with increasingly connected international supply chains.
- d. Some definitions expressly exclude certain events. For example, some contracts may provide that a party’s lack of funds (however arising), or an increase in the cost of its labour or materials, will not be deemed a force majeure. These exceptions may become meaningful if the current pandemic does not directly affect activities at the project site, but otherwise affects a contractor’s ability to pay for needed materials.

2. *Conditions for relief*

- a. The affected party typically has the burden of demonstrating that the event meets the applicable definition and the other criteria set out in the contract.
- b. It will be important to review whether the alleged force majeure has actually impacted the party claiming relief. The constant stream of news regarding the virus and the preventive measures announced by governments have contributed to some of the fear and uncertainty. However, such fear and uncertainty may not always be reasonable grounds for shutting down a construction site, especially where a contractor may take reasonable measures to mitigate employee concerns and keep construction going (more on the duty to mitigate below).
- c. Contracts typically require that the affected party give prompt notice of the force majeure to the other party. The affected party may be required to detail current and anticipated impacts, and indicate the expected duration of the event. Where a force majeure is continuing or the situation is otherwise evolving, the contract may require regular updates and reporting of extra costs.
- d. Stricter contracts may place a time limit on force majeure notices, with the affected party waiving its entitlement to relief if it fails to give notice within the specified period following the event.
- e. Relief under certain contracts may be dependent upon following claim procedures under a “superior” contract, the provisions of which have been “flowed down” to the applicable contract. The extent of relief may also be limited to such relief as is granted under the superior contract.

3. *Relief for force majeure*

- a. Generally, a force majeure event will only temporarily excuse performance of those obligations impacted by the

event. Both the affected party and the unaffected party must continue to perform other obligations that are unaffected by the force majeure.

- b. The affected party may claim extension of the time for performance, based on the impact of the event. In other words, performance of the affected obligation is suspended for as long as the force majeure prevents performance of such obligation.
- c. Many contracts specify that, while the affected party is entitled to additional time for performance, “each party bears its own costs of the delay.” Others go further and, for example, require the contractor to maintain safety and security at the work site at its own cost. These contracts frequently include longstop dates, entitling either party to terminate the contract if the force majeure event continues for an extended time (more on that below).
- d. Most contracts provide that the obligation to pay money in a timely manner is not excused by a force majeure event. This language is usually aimed at owners and could prove challenging if accounting staff in charge of paying the contractor’s invoices is sent home to limit the risk of contagion.

4. *Duty to mitigate*

- a. It is a general principle of construction contracts that all parties to a contract have a general duty to mitigate and minimize the impact of adverse events. This will apply to COVID-19. COVID-19 will not be interpreted as an event that completely relieves a party from its contractual obligations. Depending on the circumstances, this duty to mitigate could include the spending of money by the affected party. We generally recommend that both parties cooperate to try to do what is best for the project. There is no downside and only upside if you do this under a without prejudice umbrella.
- b. The contract may also make mitigation by the affected party a condition of any relief.

5. *Termination rights*

- a. Certain contracts allow either party to terminate the contract if performance is prevented due to force majeure for a certain number of consecutive days or a certain number of non-consecutive days. The relevant clauses are often referred to as allowing termination due to “extended FM” and may require that “all or substantially all” of a party’s obligations be affected by force majeure for the specified duration before either party may terminate the contract. The implied strategy is that both parties agree to share the costs of the unanticipated delay up to a limit.
- b. Where the contract provides that the contractor will receive no cost relief in connection with a force majeure, but no termination right for extended FM is provided, the contractor may become unable or unwilling to absorb the costs of a force majeure that has no end in sight. Faced with the choice of sharing in the contractor’s pain or watching the contractor walk away from the project, the owner will need to be prepared to negotiate an acceptable compromise.
- c. Where a party may have its own reasons for wanting to exit a particular contract, it may be tempted to take advantage of a seemingly indefinite force majeure event (such as the current pandemic might seem) to start the countdown toward its ability to terminate for extended FM. That is another reason for vigilance when considering a notice of force majeure, especially if such notice only invokes generalities and does not meet all conditions for relief under the contract.

Government action and relief

Parties will want to stay aware of government initiatives aimed at alleviating the impacts of the coronavirus. In time, as seen in China, these may include tax relief and various subsidies for impacted businesses. While such support initiatives should not affect the interpretation of contracts impacted by COVID-19, the availability of relief from governments may facilitate the resolution of force majeure claims and related disputes.

New contracts

New contracts entered into during this time of uncertainty will likely be interpreted differently, if only because the parties knew of the existence of the virus when they signed on the dotted line. It is arguable that neither party should be able to invoke the evolving situation as an excuse to defer performance of its obligations. For those contracts, it would therefore seem prudent to set out common assumptions regarding the expected consequences of the infection, including, for example, to set a baseline beyond which an affected party would be entitled to invoke the force majeure protections under the contract.

We can help

Dentons' global Construction and Infrastructure group uniquely combines both dedicated solicitors and seasoned disputes lawyers, working side-by-side to assist clients throughout the entire life cycle of construction projects, big and small. We provide project advice before and after the execution of contracts, to help owners and contractors structure relationships and address project issues before they become disputes. Please do not hesitate to contact any of us to discuss your questions regarding COVID-19 and its impact on your construction project.

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1. COVID-19 – Is it a force majeure, material adverse change or material adverse effect?
Coronavirus and force majeure: Can we exit construction contracts affected by COVID-19?↔

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