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Addressing COVID-19 in future contracts for your construction project

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There has been an abundance of recent commentary on how the COVID-19 pandemic might be treated under existing construction contracts. Based on lessons learned to date, and given the need for the construction industry to move forward, it makes sense for parties to address the risks of the COVID-19 pandemic for forthcoming projects. Every project is different and alternative risk allocation models involve careful analysis and drafting, but there are some broad commercial approaches that parties could consider in updating their template contracts to deal with the known and unknown consequences of the pandemic for future projects. The applicability of each approach will require an informed evaluation of the associated risks and potential outcomes:

**APPROACH 1 – STATUS QUO**

This approach does not involve ignoring risks associated with the pandemic. It means deliberately not making changes to the *force majeure*, stop work orders, change in law and other provisions of your current contract template, thereby allowing the existing terms to “speak for themselves” on the new project. For example, this might be an appropriate approach for cost-plus contracts (such as a CCDC 3 without a guaranteed maximum price) or contracts for consulting services without a fixed performance schedule. Alternatively, your contract template may already be clear on the allocation of the relevant risks or you may be able to transfer the relevant risks to other parties. However, uncertainty about the extent to which the impacts of the pandemic are accounted for under the existing terms of the contract (for example, pricing and payment, contract time and schedule, applicability of *force majeure* or change in law provisions, or termination rights) can lead to disputes and other project disruptions.
**APPROACH 2 – CONTRACTOR ASSUMES ALL SCHEDULE AND PRICE RISK ARISING FROM EXISTING OR FUTURE PANDEMIC CIRCUMSTANCES**

Under this approach, all risks of delays and increased costs arising from a pandemic are assumed by the contractor as part of the contract price and contract time. There may be limited exceptions to this risk transfer (e.g., negligence or fault of the owner or its other contractors). The contractor will include contingency in its schedule and price under this scenario and will bear the risk that such contingency turns out to be insufficient. On the other hand, circumstances associated with the pandemic could turn out better than expected (e.g., rapid development of treatments or vaccines, better than expected immunity or less impact on construction productivity) and some impacts may have a beneficial effect on costs (e.g., lower prices of fuel, or improved availability of construction equipment, supply chains and labour), in which case the contractor would enjoy the upside. Of course, competitive procurement may mitigate against the contractor’s ability to carry large contingencies to deal with this risk transfer. This approach requires revisions to the template contract to confirm that subject to any specified exceptions, no events or impacts associated with the COVID-19 pandemic give rise to compensation for increased costs or changes to the schedule.

**APPROACH 3 – CONTRACTOR ASSUMES NO RISK OF DELAY OR INCREASED COSTS ARISING FROM UNANTICIPATED CIRCUMSTANCES RELATING TO THE PANDEMIC**

Under this approach, the risks of delays and increased costs arising from unanticipated impacts of the pandemic are assumed by the owner. As many conditions of operating in a pandemic environment are currently known (e.g., the need for physical distancing, PPE and cleaning), it will be critical to clearly articulate the current or anticipated future effects of the pandemic that are accounted for in the scope of the work and schedule. It is only with a well-defined description of the “baseline” conditions that a contractor’s request for cost and schedule relief arising from differing circumstances can be properly evaluated. This may require considerable effort to properly articulate, a point that should be taken into consideration when setting procurement timelines. Parties should also consider whether the owner should be entitled to adjustments if actual conditions turn out to be more favourable than the baseline.

**APPROACH 4 – CONTRACTOR ASSUMES COST BUT NO SCHEDULE RISK ARISING FROM UNANTICIPATED COVID-19 PANDEMIC CIRCUMSTANCES**

As with certain of the other approaches, provisions of the contract will need to be revised to the extent necessary to align with this allocation of risk. Similar to Approach 2, the price will include a contingency relating to the COVID-19 pandemic, although unlike Approach 2 the schedule will not. As with Approach 3, the distinction between baseline and unanticipated conditions needs to be clearly articulated.

**APPROACH 5 – CONTRACTOR AND OWNER AGREE ON A CONTINGENCY FOR COST AND TIME IMPACTS WHICH MAY BE APPLIED WHEN THE CONTRACTOR INCURS COST OR EXPERIENCES DELAY ARISING FROM UNANTICIPATED COVID-19 PANDEMIC CIRCUMSTANCES**

Such a contingency represents the maximum cost or extension of time to which the contractor would be entitled. This model is not a unique concept in principle, and shares some similarities with allowance provisions seen in other construction contracts, (e.g., “Wind Delay Days” to address situations when high height activities cannot proceed due to winds exceeding a certain measured velocity). Like Approach 4, it
can be thought of as is a middle ground between Approaches 2 and 3. As with Approaches 3 and 4, this approach requires that the distinction between baseline and unanticipated conditions be clearly set out, in addition to the mechanism for price or schedule adjustment using the applicable contingency.

The practical realities of quantifying baseline conditions and/or contingency and subsequently administering such provisions may not be straightforward and will require careful consideration, accounting for such things as impacts on productivity, labour rates and unplanned demobilization and remobilization costs. However, it is important to note that under Approach 5, the contractor assumes the risk of costs or time exceeding the agreed contingency.

**OTHER CONTRACT PROVISIONS TO REVIEW**

Regardless of the commercial model adopted by the parties to allocate the risk of cost and delay on any given project, there are various terms in typical construction contracts that should be reviewed and potentially adjusted in the context of the COVID-19 pandemic in addition to the more obvious provisions relating to force majeure, stop work orders, change in law, and scope and change orders. Such provisions may include termination rights (including termination for prolonged delay), provisions dealing with mitigation of losses, indemnification, concealed or unknown conditions, health and safety obligations, insurance, limitations of liability and schedule liquidated damages or bonuses.

While the foregoing considerations and approaches may be a useful starting point, each contract should be examined in the context of the specific project and the potential impacts of the ever-evolving pandemic dynamics and the applicability of these concepts to other events beyond the control of the parties, including other pandemics. We have been actively assisting our clients in adapting their contracts to address these extraordinary circumstances (in addition to supporting their analysis of implications under their existing ones) and would be pleased to assist you in this regard as well.

In our webinar, “Claims in the time of COVID-19: A Construction Lawyer’s Perspective”, lawyers in Osler’s Construction Group discuss how industry stakeholders in North America are anticipating, preparing for, and managing claims and disputes resulting from the COVID-19 pandemic.
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