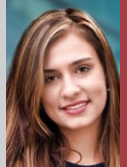




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Exceptional international events and construction contracts – the nightmare continues

There's no doubt that several exceptional international events have occurred over the last few years, particularly from the start of 2020, which have had and will continue to have long-lasting effects on the entire construction industry.

A recent example of an exceptional international event is the Covid-19 pandemic which resulted in multiple national lockdowns and ushered into effect multiple new laws to curb its spread. The pandemic has had a devastating impact on many industries, including the construction sector.

Just as people and businesses seemed to be adjusting to living and working amid a pandemic, tensions started to rise between Russia and Ukraine. Global concerns about the possible outbreak of war were realised on 24 February 2022, when Russia launched a full-scale invasion of Ukraine. This is the second exceptional international event to occur in the space of less than two years. At the time of writing, the Russia-Ukraine war is ongoing with no sign of abating.

In response to the Russia-Ukraine war, numerous extraordinary steps have been taken by the global community, including economic sanctions and boycotts. The humanitarian

concerns of the war are immense and grave, while the economic effects have already begun to impact individuals and businesses worldwide.

Social media newsfeeds highlight the rising fuel prices on the back of higher oil prices. But fuel is not the only commodity affected by the war. Russia imports and exports multiple commodities and the sanctions imposed against the country will cause shortages across several commodities, driving above-inflation price increases.

Economists are predicting that the already higher costs of living will only continue to climb in the face of the Russia-Ukraine war. Given that South Africa's economy has not yet recovered from the effects of the pandemic, businesses are now rightly concerned about how the war may impact them. Contractors in the construction industry are anticipating economic pressure.

A BRUTAL WAKE-UP CALL

The pandemic highlighted the importance of correct contract documentation and ensuring that there is a clear understanding in respect of what has been signed by the parties. At the beginning of the pandemic, much focus was placed on *force majeure* clauses in contracts to mitigate the delays and other losses suffered by contractors due to the pandemic, lockdowns, and changes in laws.

However, as the pandemic progressed, employers began adopting the view that the pandemic was no longer an unforeseen event and that contractors should instead start making provision for it and its effects when tendering. As a result, it has now become common place for contractors and employers to include clauses in their contracts to deal with Covid-19 events and associated effects.

RUSSIA-UKRAINE WAR'S IMPACT ON CONTRACTORS AND EMPLOYERS

The consequences of the Russia-Ukraine war are already wreaking havoc worldwide. It is therefore prudent to consider the associated difficulties and risks faced by contractors in South Africa and ways to mitigate those risks. First, what are some of the practical difficulties that contractors may face due to the war? While the following list is not exhaustive, the expectation is:

- Exceptional increases in the price of oil, which in turn will lead to higher costs to run construction plant and equipment as well as increased staff transport costs. Costs of material such as uPVC are likely to go up along with staff living costs.
- Shortages of other construction goods and materials such as steel due to sanctions and embargoes.
- Increases in the costs of basic foods. Russia and Ukraine export a quarter of the world's wheat. Without this supply, prices will soar which will impact individual cost of living and staff meals. In turn, cost of living increases will create pressure for wage negotiations with unions.

Contractors who have concluded fixed-price contracts or who have agreed to escalation formulae will be faced with price increases that cannot be recovered from employers. At MDA Attorneys, we are assisting several clients by negotiating clauses into their new contracts to protect them from the future impacts of exceptional price increases. But what about contracts that are currently being executed?

STANDARD FORM CONTRACTS AND RISK

The South African construction and engineering industry utilises four standard form suites of contracts, namely the FIDIC, NEC, GCC and JBCC. Each of these standard form contracts manages and apportions risk differently. What is common in each suite is that provision is made for unforeseen events or events that cannot be provided for when the contract is concluded. The entitlements under these provisions differ from contract to contract and are sometimes subject to amendment.

CLAUSES RELEVANT TO CONTRACTORS

FIDIC 1999 – clause 19.1 read with 19.4

Clause 19.1 defines *force majeure* as “an exceptional event or circumstance (a) which is beyond a party's control, (b) which such party could not reasonably have provided against before entering into the contract, (c) which, having arisen, such party could not

reasonably have avoided or overcome, and (d) which is not substantially attributable to the other party.” It specifically includes war and hostilities as acts of *force majeure*.

Clause 19.4 provides a mechanism for a contractor to submit a claim if any act of *force majeure* prevents them from performing their obligations in terms of the contract. Where a contractor can show that the war has prevented them from performing their obligations, they will be entitled to claim the time and costs associated with such prevention.

Therefore, if a contractor has entered into a FIDIC contract and is somehow prevented from executing or completing the works due to the Russia-Ukraine war, clause 19.1 read with 19.4 could be used to submit a claim for an extension of time and the associated costs.

The NEC 3 ECC

Clause 80.1 of the NEC3 provides a list of employer's risks which includes, “Loss or damage to the works, plant and materials due to war, civil war, rebellion...” and clause 60.1(14) provides that an event which is an employer's risk can give rise to a compensation event. As this clause deals with physical loss and/or damage caused to the works or plant and materials which is occasioned due to war, it seems highly unlikely to find application to the current circumstances.

Clause 60.1(19) provides that an act which “stops the contractor completing the works or stops the contractor from completing the works by the date shown on the accepted programme” and which “neither party could prevent, [and which] an experienced contractor would have judged at the contract date to have such a small chance of occurring that it would have been unreasonable for him to have allowed for it and is not one of the other compensation events listed in the contract.” This clause may entitle the contractor to submit a claim based on delays caused by a war. However, it does not deal with the situation where the contractor is able to complete the work, but at an increased cost.

The GCC, Third Edition, 2015

The GCC 2015 is possibly the most useful of the standard form contracts in the context of the Russia-Ukraine war as it provides a mechanism for the contractor to submit a claim for additional costs in the case of war and/or economic sanctions.

Clause 8.3.1.1 states that, “The excepted risks are risks of damage or physical loss or any other loss caused by or arising directly or indirectly as a result or consequence of war, invasion, act of foreign enemies, hostilities or warlike operations (whether war be declared or not) or imposition of economic sanctions between governments...”.

Clause 8.3.2 states that, “If, in carrying out the works, any of the excepted risks other than pertaining to the damage and/or physical loss referred to in Clause 8.2.2.2, causes the contractor to suffer delay to practical completion and/or brings about proven additional costs, the contractor shall be entitled to make a claim in accordance with Clause 10.1”.

The negative aspect of this clause is that it contains a closed list of excepted risks. This means that if the exceptional international event which is causing the additional costs does not fall within the ambit of this clause, then the contractor has no remedy available.

The JBCC (Edition 6.2) May 2018 contains a mechanism to extend the contract date in the case of a *force majeure* event but does not provide a remedy for additional costs occasioned by such an event unless it is to deal with physical damage to the works.

LIMITATIONS OF FORCE MAJEURE AND IMPLICATIONS

The clauses in concluded standard form contracts may provide relief, however these clauses do not provide for every situation, nor can they reasonably be expected to. Most are only useful if the event in question has not been foreseen and/or cannot be provided for at the time when a contract is concluded. For this reason, they are only of use to contractors who have already concluded contracts.

Our concern at MDA Attorneys is that the limitations experienced with the *force majeure* clause during the progression of the Covid-19 pandemic will create similar problems for contractors who are negotiating and entering into contracts now, in that the Russia-Ukraine war can no longer be regarded as an “unforeseen” event. Contracts are drafted to apportion risk, and in this regard, it is simply untenable to expect a contractor to assume all the risk in relation to the cost implications of an exceptional international event.

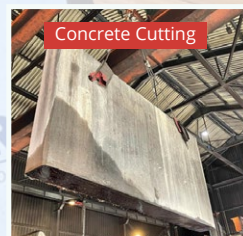
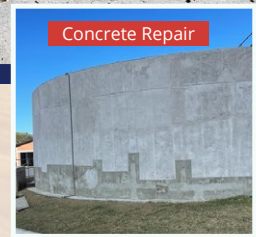
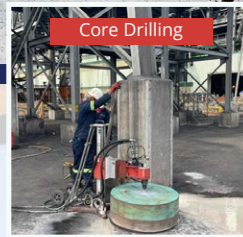
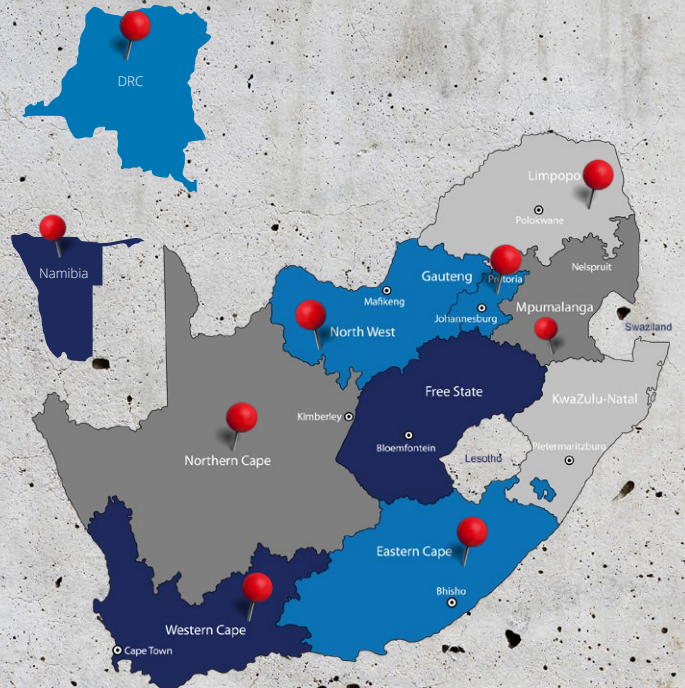
Where they are available, the mechanisms included in most standard form construction contracts are flawed. Most contracts do not allow for cost increases, but those which do are based on escalation, or calculations fixed at the time that the contract is concluded. They therefore do not allow for the extraordinary price spikes we are currently seeing, and possible future price increases.

It is clear that provision can and should be included in contracts going forward for mechanisms to deal specifically with price and cost increases due to exceptional international events.

MDA Attorneys is preparing appropriate clauses for inclusion in contracts which will entitle contractors to address cost increases due to exceptional international events through the mechanism of submitting claims. In this event, standard claim procedures contained in the contract would apply. The engineer/project manager/employer’s agent and/or principal agent would adjudicate over such a claim. If the claim is rejected, standard procedures would apply for the contractor to dispute such rejection.

In addition to including clauses in contracts to deal with higher costs due to exceptional international events going forward, employers should, at the very least, be open to negotiation on their inclusion in contracts. Failure to do so could have far-reaching effects. Contractors could end up running projects at a loss, they may fail to draw a profit on a project, or they may even be deterred from tendering for projects in the first place. Those who do choose to tender and take on the risk of exceptional international events could be forced to close their doors if the costs become too much to bear. A further decline in the construction industry could ensue on account of reduction in resources.

Now is the time to include clauses to deal with potential extraordinary price increases. There is no doubt that more price hikes will negatively affect the execution of construction projects going forward. □



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