



# COVID-19 PANDEMIC AND LESSONS LEARNED FOR CONSTRUCTION CONTRACTS

## PREFACE

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## **I. PREFACE**

As is public knowledge, in December 2019, the hospitals of Wuhan city, capital of the Hubei province, in the People's Republic of China, detected the first cases of a disease caused by the virus SARS-CoV-2 (“coronavirus 2 of severe acute respiratory syndrome”, “COVID -19”).

After beginning to show a rapid increase in infections in different countries of the world, on March 11, 2020, the World Health Organization declared COVID-19 a pandemic.

The delicate health situation that the world population has experienced during the last few months has led to countries imposing travel restrictions, quarantines, confinements, social distancing, cancellation of events, and closure of establishments, among other measures.

In this context, the construction industry has been strongly affected by at least two significant phenomena: a) the total stoppage of projects, and; b) continuation of contracts under abnormal or extraordinary circumstances.

Regarding the first of the aforementioned cases, there is a certain global consensus that we are experiencing a force majeure, regulation of which is covered by statutory laws almost worldwide.

However, not all construction projects have been stopped. Indeed, some countries have determined that even under existing limitations and new health and safety requirements imposed by the authorities, construction is an essential activity. Therefore, the execution of construction contracts must continue, an issue that makes impossible the invocation of force majeure by contractors.

Thus, those contractors who had entered into private projects or public works contracts with the State, before the recognition of COVID-19 as a global pandemic, have had to continue construction under abnormal or extraordinary circumstances. As a result, fulfilment of obligations has become onerous, and introduced a lot of uncertainty over respective contracts.

In practice, contractors have been obliged to implement new on-site health regulations as well as purchasing safety masks, gloves, and other PPE. Delays in receiving these supplies in addition to the usual equipment required has created extra problems.

The extraordinary measures contractors have had to adopt to continue construction works have resulted in not only loss of productivity but also the extended employment of personnel and resources way beyond what was originally planned. In practice this has meant a radical change in work methods, with all their attendant time and cost consequences.

Despite clear evidence of these facts, authorities, employers, and legal bodies in many countries are not adequately reviewing or even recognizing the impact of this situation. The assumption is that the consequences of the pandemic will be borne solely or mainly by the contractors, as part of the risks of the contract. This undoubtedly disrupts the employer-contractor dynamic, which can only be detrimental to the industry long-term.

Considering the above, it is worth CICA asking what is being learned from this situation and how we can best advance construction projects under such extraordinary conditions, and with least impact on all participants.

**II. DIAGNOSIS – WHERE ARE WE NOW AND WHAT TO DO?**

The following table identifies key aspects of the construction process along with possible solutions as identified through conversations with specialized and public resources. It is not exhaustive, but we believe it covers the most important and relevant issues under the present circumstances:

STAGE	DIAGNOSIS	POSSIBLE SOLUTION
<p><b>Tender process</b></p>	<p><b>Non-use of standard forms of construction contracts:</b></p> <p>In many cases, standard forms of construction contracts showed benefits thanks to a more balanced situation between parties. Sadly, standard construction contracts are not used in many jurisdictions.</p>	<p>The institutions issuing standard forms of construction contracts should adopt guidelines and/or addenda to their standard contracts to establish risk allocation between employer and contractor on an effective and fair basis in the face of pandemics of this scale.</p> <p>FIDIC, the sector leader in this area, already took action and issued guidelines.</p> <p>Ongoing training in use of standard construction contracts (employers and contractors) is essential.</p>
	<p><b>Treatment of extraordinary circumstances like COVID-19:</b></p> <p>Contractual clauses in traditional contracts include no provision for managing extraordinary circumstances, using instead the same framework as for a regular case of force majeure.</p>	<p>Review the wording of the contracts, particularly risk balance in case of extraordinary circumstances.</p> <p>Tendering contractors must understand that scrutinizing the bidding documents as well as raising questions and requesting clarifications on risk allocation on COVID-19 and similar issues, is essential to correctly price their bid and to raise the issue for the employer at the outset.</p>
	<p><b>Lack of collaborative approach:</b></p> <p>Even considering the fact that the economy is facing probably the most difficult challenges in modern history, tender processes are not including a collaborative project delivery system or even a collaborative project management approach.</p>	<p>Consider the use of collaborative and more flexible contracting models.</p> <p>Include contractual provisions to provide parties with sufficient tools and measures to jointly manage new conditions and execute works in the most efficient manner.</p>

	<p><b>Applicable law is usually insufficient:</b></p> <p>Remedies outside the contract were sought in the case of poorly or strictly drafted contracts: hardship or even impossibility concepts were triggered under certain jurisdictions. This fairly demonstrated the importance of exclusivity provisions (to the exclusion of other legal remedies under applicable law) in the contracts.</p>	<p>It is crucial to analyze the applicable law of the contract at the tender stage in order to determine the additional risks or benefits that a specific contractor may have. It has also been seen that most governments have not taken specific measures to mitigate the effects of the pandemic. Therefore, contractors should also make sure to consider and list all relevant local legal measures that become applicable in the project tendered for.</p> <p>This will ensure appropriate additional clauses are included in the contract should applicable law or measures be insufficient to deal with the issue.</p>
	<p><b>Integrity and Anti-corruption:</b></p> <p>Direct award of construction projects justified by the pandemic, instead of public bids, have been a concern in many jurisdictions.</p> <p>Also, concern over governmental decisions abandoning compliance and integrity rules, have been of extreme concern everywhere.</p>	<p>Contractors are encouraged to take action whether directly or through their associations in respective countries, to oppose such application for the ultimate long-term benefit of the construction industry where anti-transparent practices constitute the source of significant harm.</p>
	<p><b>Financial health:</b></p> <p>The pandemic has shown how the financial health of many employers was not sufficiently robust to deal with the crisis effectively.</p>	<p>Appropriate mechanisms for suspension of the works in case there is a justifiable concern on the financial capacity of the employer should be included in contracts so that the contractors do not risk self-financing of a project.</p> <p>Inclusion of health supplies and medical support should be considered in the financial analysis during the tender process.</p>

	<p><b>Limited liability of contractors-</b></p> <p>The limited liability of contractors under exceptional circumstances has been questioned: employers impose an obligation to assume the burden of costs derived from COVID-19 on contractors in many cases.</p>	<p>Include adoption of employer risks such as COVID-19 in contracts.</p> <p>Establish the burden of extra costs raised by legal procedures, force majeure and hardship that occur after the contract is signed.</p> <p>Include reimbursable cost as a mechanism to determine the amount paid to the contractor.</p> <p>Extra costs arising from measures to manage such events (whether legally imposed or not), and/or the impact on time and execution of works.</p>
<p><b>Project execution</b></p>	<p><b>Health and Safety:</b></p> <p>While in the past this mainly addressed accidents, the “new normal” prompts us to reconsider health matters on site, as well as mental health measures for staff and workers.</p>	<p>Appropriate budget and payment mechanism should be included in bids or internal project management plans so as to ensure the execution phase runs smoothly under “new normal” circumstances.</p>
	<p><b>Contract management:</b></p> <p>The overall general lesson is that drafting and wording of contracts and contractual risk analysis before concluding the contracts is as important as executing the associated works.</p>	<p>Proper drafting should be followed by management of specific clauses on COVID-19 or similar. Notice should be given in a timely manner and issues thoroughly addressed to ensure that any postponement due to cost or time impact is not at the employer’s discretion.</p>
	<p><b>In-depth analysis proved once again significant for proper contract interpretation:</b></p> <p>Assessment of not the event itself (a controversial force majeure) but its consequences (changes in law - hardship) was required to accurately address liability between parties.</p>	<p>Considering COVID-19 (or similar situations) as one “exceptional circumstance”, giving an integral treatment to the event itself and its consequences.</p>

	<p><b>Extent of “mitigation” liability of the contractor:</b></p> <p>This topic (whether directly or indirectly) was significantly questioned. Can this actually extend to measures taken to perform works under the “new normal”? Can COVID-19 measures be merely treated as HSE requirements, updated from time to time throughout the contract?</p>	<p>We approach this matter rigorously to underline that a pandemic-related measure may not be considered merely a HSE compliance matter where the contractor absorbs the risk.</p> <p>Separate clauses on force majeure (or change in law) would otherwise be null and void.</p>
<p><b>Dispute Resolution</b></p>	<p><b>Dispute resolution mechanisms:</b></p> <p>Existence of proper dispute resolution mechanisms was once again appreciated and the lack thereof proved fatal, usually to the significant disadvantage of contractors. Mediation and Dispute Boards are showing their benefits.</p>	<p>Contractors are encouraged to make full use of existing mechanisms for a timely resolution of issues. The guidelines published by institutions such as the Dispute Resolution Board Foundation (DRBF - for disputes) and International Chamber of Commerce (ICC - for arbitration), should be followed under the “new normal.”</p> <p>It is highly recommended that standing Dispute Boards be implemented for projects.</p> <p>It is vital to implement a Fast-Track decision-making process over time/cost consequences to contracts, such as those risks posed by COVID-19.</p>
	<p><b>Force Majeure:</b></p> <p>The concept of “Force majeure” has been controversial and poorly understood even in a global pandemic where the ordinary course of the business was ceased at a global scale for months.</p>	<p>Force majeure clauses should be amended to suit present application. Regarding future contracts, parties would do well to bear in mind that determining the extent of a force majeure and its consequences could help to avoid disagreement when applying these clauses.</p>

### III. WHAT HAVE WE LEARNED?

The main lesson learned is that traditional contracts have not by themselves been able to solve the situation to the level required. Unfortunately, in many countries, the solution adopted continues to be the strict application of clauses in a contract that obviously was not designed for these extraordinary conditions. The simplistic solution of displacing the risk to the contractor alone, is inefficient, destroys mutual trust and greatly impacts on the economic effects for the construction industry.

Indeed, no employer can survive in a construction industry where major contractors are deeply affected both operationally and financially owing to poorly managed risk allocation policies. Therefore, in the long-term it is vital for all actors that appropriate risk allocation mechanisms be included in existing contracts. In this way, contractors will also be motivated to take proper action for existing contracts.

The other lesson learnt regards future contracts. Here, an entirely new fair contract structure should be adopted in order to overcome the potential burden of unfair risk attribution upon contractors and suppliers. Contractors will be more encouraged to raise their voice at the tender level when faced with these strict and unbalanced contracts. Addressing these issues before the contract is executed will ensure proper pricing and smoother execution of projects.

Also, the use of appropriate dispute resolution mechanisms surfaced once again. Often considered a last resort and as a result not effectively employed, we now see how important it is to address issues and make use of these mechanisms in a timely way. Contractors are therefore strongly encouraged to initiate such mechanisms in their existing contracts in order to overcome deadlocks imposed by those employers which do not offer any true resolution.

In summary, the global construction industry has several issues to reconsider and hopefully overcome until the pandemic finishes.

All industry actors must strive to analyze the current circumstances and foresee any such future scenarios in order to be part of the solution to this crisis. By not taking decisive steps and developing a plan to face this crisis, the industry overall could be weakened at a moment where building and infrastructure is in a position to take a leading role for the benefit of society.

***This position paper was written under the Chairmanship of Alex Wagemann with the support of the working group: Yasemin Cetinel, Elisa Figueroa, Augusto Barros De Figueiredo e Silva Neto, Christian Diaz Barcia, Manuel R. Vallarino Q, Roberto Hernandez, Fanny Dastugue, Amélie Schafer and Andine Canton.***



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