[2020] NZLJ 144

Suspension of construction contracts in the time of COVID-19

Kelly Quinn, Bankside Chambers, Auckland, considers the arguments

With apologies to Gabriel García Márquez, the title sums up both the subject-matter of this article, and its goal. In short, my argument is that under NZS 3910:2013 (generally thought to be the most commonly used standard form contract for non-residential construction projects in New Zealand), the Engineer ought to have issued a notice of suspension in response to the COVID-19 lockdown. Further, the lockdown is not an event falling within the scope of cl 5.11.10 which addresses change in law.

Most industry participants with an interest in construction law will have read the Guidance Note published by the Procurement and Property department of the Ministry of Business, Innovation and Employment (MBIE) on 7 April 2020. Titled even less poetically than this article, MBIE's "Guidance for public sector agencies dealing with the contractual implications for construction projects of the COVID-19 lockdown period" (Guidance Note), addresses the contractual position under NZS 3910:2013. The Guidance Note takes the following position:

(a) Many Engineers have issued instructions to suspend pursuant to clause 6.7.1 on the basis that suspension of the Contract Works has "become necessary", and in such cases the Contractor is entitled to a Variation under clause 6.7.3 because the suspension is not due to default by the Contractor;

(b) However, in cases where the Engineer has not issued a suspension notice, it is clear that the Principal and the Contractor are obliged to stop any non-essential works in order to comply with the Level 4 lockdown directive. The Guidance Note says the restrictions put in place by the Government "all emanate from regulations or statutes" and that consequently whether the Engineer has suspended under cl 6.7.1 or not, the Contractor will be entitled to a Variation under cl 5.11.10.

(c) The Guidance Note observes, correctly, that increased costs arising from a change in law (within the meaning of cl 5.11.10) will be treated as a variation, in the same way that costs associated with a suspension under cl 6.7.1 will (by virtue of cl 6.7.3) be treated as a variation, assuming the event leading to suspension is not the fault of the Contractor.

So, the Guidance Note appears to encourage or at least endorse suspension, without actually stating that cl 6.7.1 is engaged in these circumstances. It then goes on to advise in bold type that if the Engineer has not issued a suspension instruction then not to worry — the Government's response to COVID-19 constitutes a change in law so the Contractor is still entitled to a Variation and protected as if there were a suspension.

MBIE's intention in issuing the Guidance Note is laudable. It is evident from the balance of the Guidance Note that MBIE is genuinely thinking about the financial well-being of Contractors working on Government projects, both for the sake of the Contractor and on a "best for project" basis as well. At the conclusion of the Guidance Note, MBIE urges Government agencies involved in construction projects to consider whether additional extra-contractual financial relief is warranted and in the public interest for Contractors who have been affected by COVID-19.

That is exactly the sort of approach that Government ought to be taking, but it is unlikely to be widely followed in the private sector. My own experience in the first week or so of the lockdown was that developers and other private sector principals were generally intent on urging Contractors and Engineers towards a simple extension of time for an unforeseen circumstance, per cl 10.3.1(f), for which no time-related costs would be payable. In contrast, Contractors were generally attracted to the change of law approach but were willing to hedge their bets by also asking Engineers to issue a notice of suspension. Engineers, for their part, were uncertain and anxious not to make the wrong decision (it was ever thus).

THE ARGUMENT FOR CHANGE OF LAW IS WEAK

In the present circumstances, the relevant portion of cl 5.11.10 reads:

> If after the date of closing of tenders the making of any statute, regulation, or bylaw … increases … the Cost to the Contractor of performing the Contract … the effect shall be treated as a Variation.

The question raised is whether there has been any "statute, regulation, or bylaw" made as part of the Government's response to COVID-19 which has increased the cost of performance for Contractors. The conclusion in the Guidance Note is that there has been, but the reasoning is weak. The Guidance Note analyses the position as follows (emphasis added):

> The Government's interpretation is that the various restrictions put in place by the Government, including moving to COVID-19 Alert Level 4, *all emanate from regulations or statutes*. These include the Infectious and Notifiable Diseases Order (No 2) 2020 which came into force on 11 March 2020 and added 'Novel coronavirus capable of causing severe respiratory illness' to the list of notifiable diseases, which in turn enabled the establishment of the Alert Level 4 directive. These actions by the New Zealand Government would constitute the making of a statu[t]e and/or regulation giving rise to a variation claim under clause 5.11.10.

What did the "Infectious and Notifiable Diseases Order (No 2) 2020" made on 9 March 2020 actually do? The explanatory note appended to the Order is as follows:

> **Explanatory note**
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> *This note is not part of the order, but is intended to indicate its general effect.*
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> This order comes into force on 11 March 2020. It amends the Health Act 1956 by—
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> - adding COVID-19 to the list of infectious diseases notifiable to a medical officer of health in Section B of Part 1 of Schedule 1 of that Act; and
> - adding both COVID-19 and novel coronavirus capable of causing severe respiratory illness to the list of quarantinable infectious diseases in Part 3 of Schedule 1 of that Act.
>
> COVID-19 is an infectious agent causing flu-like symptoms that first came to official notice in Wuhan, China in December 2019. On 30 January 2020, novel coronavirus capable of causing severe respiratory illness was added to the list of infectious diseases notifiable to a medical officer of health in Section B of Part 1 of Schedule 1 of the Health Act 1956 by the Infectious and Notifiable Diseases Order 2020. Since then, that outbreak of novel coronavirus has been named COVID-19.
>
> The consequence of this order is that COVID-19 and novel coronavirus capable of causing severe respiratory illness are both separately listed as infectious diseases notifiable to a medical officer of health, as well as quarantinable infectious diseases.

As can be seen, Order (No 2) made on 9 March 2020 (effective from 11 March 2020) was essentially updating an earlier Order made on 30 January 2020, which had originally added (effective 31 January 2020) "novel coronavirus capable of causing severe respiratory illness" to the schedule of notifiable infectious diseases. The subsequent Order (No 2) recorded its name, COVID-19, and added both COVID-19 and the more generic description to the list of quarantinable infectious diseases.

It is telling that the Guidance Note says that the restrictions put in place by the Government all "emanate" from regulations or statutes. That they do. But the power to impose such restrictions is a power that has existed for many years. The Government is exercising a combination of powers conferred under or established by the Health Act 1956, the Civil Defence and Emergency Management Act 2002, and the Epidemic Preparedness Act 2006. The mere recognition of COVID-19 as an infectious disease does not immediately appeal as the making of a statute or regulation that itself increases the cost of performing construction contracts.

It is not difficult to imagine a scenario in which New Zealand's borders were closed sooner, and COVID-19 either did not find its way to our shores at all, or the number of infections were so low that we never moved beyond Alert Level 2 or 3. (Note that at the time of writing it seems reasonably clear that construction will be permitted to resume under Level 3.) In those circumstances, the presence of COVID-19 on the list of notifiable diseases would be no more relevant than the presence of Cholera (also on the list). It would not have led to the shutdown of construction sites.

The true intent of cl 5.11.10, one infers, is to deal with the situation where the Government enacts legislation that directly affects the cost of carrying out construction work. For example, if the Government enacted legislation enforcing a strict 30 hour working week with immediate effect, that would inevitably delay the completion of projects that were already underway, and thus increase the cost of performance. Similarly, if the Government introduced legislation, whether by statute or Legislative Instrument (which, prior to August 2013, were generally known as "Regulations"), banning with immediate effect the use of imported steel in any structural component of a building, that would (probably) increase the cost to the Contractor of performing any contract that had already been priced on the basis that imported steel would be used.

THE ARGUMENT FOR SUSPENSION IS STRONG

It is a truism of construction law that once work is underway, that is, once the Principal has given the Contractor access to the site, the Contractor is under an obligation to make diligent progress. Generally, there will be a completion date agreed between the parties, but if not, there is still a common law obligation to complete the works within a reasonable time.

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In common with many standard form contracts, NZS 3910:2013 makes express provision for this obligation. Clause 10.1.2 provides:

> The Contractor shall commence the Contract Works within 10 Working Days after it becomes entitled to possession of the Site, or as soon thereafter as is reasonable, and shall then proceed with the execution of the Contract Works with due diligence except as may be sanctioned or instructed by the Engineer.

It will be observed that the Contractor's obligation to proceed with diligence is independent of any right to an extension of time, or any dispute over claimed extensions. So, if the Principal changes the design or orders extra work part way through the project, with the effect that there will be delay to the completion date, the Contractor is entitled to extra time and extra payment, but they are still under an ongoing obligation to continue to advance the Works. This will be so even in circumstances (very common) where there is an immediate dispute as to whether a variation and/or EOT should be ordered, that is, a dispute as to whether the design change was sufficiently material to engage cl 9.1.1, whether the extra work was truly

extra, and so on. Even in such cases, the Contractor remains at all times under the obligation to continue to progress the Works including the particular work which is the subject of the dispute.

Now, consider the wording of cl 6.7.1, the suspension provision:

> If the suspension of the whole or part of the Contract Works becomes necessary, the Engineer shall instruct the Contractor in writing to suspend the progress of the whole or any part of the Contract Works for such time as the Engineer may think fit, and the Contractor shall comply with the instruction.

On any common sense view, the COVID-19 lockdown is a circumstance rendering "necessary" the suspension of the whole or part of the Contract Works. The Engineer and the Engineer's Representative, the consulting engineers (fire, structural, geotechnical etcetera), the Contractor, all the subcontractors and all the suppliers — none of them are permitted to even attend the site, let alone progress the Works. And yet, the Contractor remains under an obligation to progress the Works "except as sanctioned or instructed" by the Engineer. The reality is that the suspension of the Works has become necessary, because if the Engineer were to "sanction or instruct" zero progress for the duration of the lockdown it would be a suspension in all but name.

There is an argument already raised by some construction lawyers to the effect that a suspension is not necessary because the Government has effectively ordered a *de facto* suspension of all non-essential construction work. There is some superficial attraction to this idea; work is suspended by virtue of compliance with the Government directives under Alert Level 4, and accordingly it is not "necessary" for the Engineer to do anything.

But this is not a sound argument. The Engineer's role, in relevant part, is to articulate and rule on the position as between the parties to the particular contract. The fact that the Government has made the decision obvious should only mean that the Engineer should have little difficulty in issuing the instruction to suspend, not that they may abstain altogether from making a decision or issuing the instruction that confirms the position as between the parties to the contract.

Consider the position with respect to building consents. If there is no building consent issued for the work in question then compliance with the law would similarly mean that the Works cannot be progressed and it is "necessary" either that they not start at all, or if they have started that they stop. But even in such a situation, where one might say that the law is clearly to the effect that Work should neither commence nor continue, issuing a formal suspension is still the correct action for the Engineer to take under the contract (see *Concrete Structures (NZ) Limited v NZ Windfarms Limited* [2014] NZHC 2118 at [28]–[32]).

Finally on this aspect, it is not necessarily the case that the Government's lockdown instruction stands as an effective instruction guiding and controlling the parties to the construction contract. Consider a project in which the Principal and Head Contractor are still engaged in an Early Contractor Involvement phase (ECI), and/or where the Contractor is involved in ECI work with its main subcontractors. It may very well be that such work can continue, or at least continue in part. The lockdown does not necessarily have any significant effect if the two parties to the contract are able to continue working remotely. If ground has not yet been broken, and the parties are still able to engage effectively in design review and discussions to review and refine methodology and so on, then it is probably not true to say that the lockdown is a *de facto* suspension of the contract. It remains for the Engineer to make his/her own assessment of whether the effect of the lockdown means it is "necessary" for the whole or part of the Contract Works to be suspended at that time.

WHAT IF THE ENGINEER FAILS/REFUSES TO SUSPEND ?

Even now, as it appears the Alert Level is about to be reduced from Level 4 to Level 3, it is still not too late for Engineers to do the right thing. There should be no impediment to the Engineer issuing a notice of suspension under cl 6.7.1, stated to apply from the evening of Wednesday 25 March 2020, when the lockdown commenced.

However, what is the result if the Engineer does not instruct suspension? Given the doubt over whether cl 5.11.10 is truly engaged, the Contractor would be well-advised to continue to push for the suspension instruction, and to insist that a suspension ought to have been instructed.

Failure by the Engineer to instruct suspension is substantively no different from a failure to order (approve) a variation when claimed by the Contractor. As a matter of objective fact, either there was a variation or there was not, and an initial refusal (for example) by the Engineer to order a variation does not prevent the Contractor from establishing a variation at a later point.

The Engineer has no discretion under cl 6.7.1 as to whether to suspend the Works — if it "becomes necessary" to suspend then the Engineer "shall" issue a suspension instruction. The only area of discretion appears to lie in the length of suspension — the Engineer is required to suspend "for such time as the Engineer may think fit." However, if the conditions which meant that suspension had become necessary remain materially unchanged, then presumably suspension will still remain necessary. The discretion would thus appear to be quite constrained, in the sense that for so long as suspension of the Work is necessary then a suspension must be instructed and remain in place. The discretion may lie mainly in the Engineer's power to order that the suspension shall extend to some point beyond the time when work has once again become possible on site.

Accordingly, a finding that it had become necessary for the Works to be suspended will lead automatically to a finding that the Engineer ought to have ordered a suspension of the Works. And if that is the position then by the combination of cls 6.7.3, 10.3.1(a) and 10.3.7 the Contractor will be entitled to an extension of time and compensation for time-related costs, the latter valued as a Variation under cl 9.3.

CONCLUSION AND FURTHER MUSINGS

For the reasons given above, the physical state of forced shutdown currently observable on construction sites nationwide (if one could go and view them), ought to be recognised by an instruction to suspend issued under cl 6.7.1 on any project governed by the terms of NZS 3910:2013.

There is no need to argue that a Government lockdown which "emanates" from regulations or statutes, all of which have long been in existence, is the same thing as the making of a statute or regulation which itself increases the cost of

performance for the Contractor. The better approach is to recognise this event for what it really is, namely a Government-imposed requirement that all non-essential construction work is to cease. Viewed in that way, the only reasonable conclusion is that it is necessary for all site-based work on such construction projects to be suspended. It will be a matter for the assessment of the Engineer as to whether there is any other aspect of the Contract Works remaining reasonably capable of performance despite the lockdown.

It might be thought that this article is pro-contractor but that is not necessarily so. A Principal might well consider whether it is really in its best interests to take the position, as MBIE advises, that cl 5.11.10 applies to the present situation. If it does apply, the result will obviously be that the Contractor will argue that the cost of performance has increased (since that is a necessary element of cl 5.11.10) and that the Contractor is entitled to a Variation and consequent compensation for that cost increase. Generally speaking, mere increased cost of performance is a risk borne by the Contractor. Bearing that in mind, a Principal might therefore prefer that the Engineer gives careful thought to which aspects of the Contract Works truly need to be suspended and which aspects can continue. If some work is able to continue, albeit by remote and perhaps more expensive means, it is not necessarily the case that the Contractor will be compensated for that increased cost.

The more difficult questions on this subject might well start to arise under Level 3 and even Level 2, when work resumes but (is potentially) subject to a variety of measures intended to prevent transmission of the COVID-19 virus. Such measures are likely to slow progress and thus add to cost. If the Engineer has taken the view (as MBIE clearly does) that there has been a change of law, then that change of law will presumably also be accepted as the cause of the altered work conditions once work on site has resumed. On the other hand, the effect of an instruction to suspend is spent once the suspension is lifted and the Contractor is remobilised back on site. At that point, if the Contractor is subject to altered work conditions which increase the cost of performance then he/she will need to identify a new basis (not the suspension) under which to recover compensation. ❐