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Everyone accepts that delays to building, construction and land development work due to COVID-19 have arisen for reasons that no one could have predicted and presented situations that are new and unexpected, but still must be tackled.

Addressing the COVID-19 challenges through good contracting behaviour by building, construction and development industry participants will protect jobs, keeps businesses and supply chains operating and support Victoria's economic recovery.

COVID-19 contracting challenges

The COVID-19 pandemic has been a shared experience for everyone in the building, construction and development industry. It has required us all to adapt how we live and work to manage the spread of COVID-19 and ensure that the industry remains safe and stays open.

It is acknowledged that the impacts of COVID-19, including illness of the workforce, closure of businesses, and restrictions on the movement of people and goods are resulting in delays and in some cases posing significant challenges for contractual performance.

The impacts caused by delays and other contractually significant events due to COVID-19 are likely to flow through the building, construction and development industry participants. Both up and down the supply chain, affecting Owners/Principals, Head and Sub-Contractors along with residential home builders.

It is recognised that consequences could be in the form of liquidated damages for delays; or for other substantial losses arising, for example, because of contracts being suspended or terminated when Principals/Owners experience changes in their financial circumstances and banks or financial institutions rescind loan approvals.

These contracting impacts may have the following outcomes:

- Impacting the viability of a significant number of head and sub-contracting companies, partnerships, sole trading and supply businesses throughout the entire building, construction and development industry supply chain.
- Significantly reducing business confidence and limiting employers' capacity in the sector to retain or engage new employees and apprentices.
- Placing a further strain on already troubling levels of industry skills shortages and significantly reduce competition in the market.
- Increasing pressure on the affordable/social housing market where Owners/Principals are forced out of contracts due to the oppressive conduct of banks or other lending institutions.

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Aim of the COVID-19 Contracting Framework

At a time when individuals are being asked to act responsibly in their personal and work lives – by staying at home, physical distancing and self-isolating – it is also right that individuals, businesses and institutions who are parties to active contractual arrangements which are materially impacted by COVID-19 should consider their behaviour as part of the building, construction and development industry response to the public health emergency.

The COVID-19 Contracting Framework aims to encourage participants in the building, construction and development industry to act fairly and reasonably in performing and enforcing contractual arrangements for building and land development work impacted by the COVID-19 crisis. It is intended to provide guidance for the parties to explore all possible resolution options and involve all relevant parties for the collective benefit of all involved.

The objectives in the Contracting Framework seek to promote a sensible, open and fair approach by all parties in contractual arrangements throughout the contracting chain by adopting a cooperative spirit to finding agreed solutions that are proportionate to the circumstances.

The principles set out a series of steps for parties supporting genuine discussions aimed at reaching outcomes that avoid, where practicable, the adverse ramifications of a delay or likely delay.

The principles are designed to foster a standard of behaviour that not only supports contracting parties but is also in the interests of supporting the ongoing safe operations and protecting jobs in the building, construction and development industry and its contribution to the Victorian economy.

It is recognised that many contracts already contain mediation and dispute resolution processes, and Courts in all jurisdictions have processes to encourage that parties hold discussions before proceeding to formal hearing.

The Contracting Framework would not disturb those processes and instead would work to reinforce the need for them to be explored in the first instance.

Case studies are presented to provide indicative examples of solutions that may be achieved under this Framework.

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Purpose of the COVID-19 Contracting Framework

The Contracting Framework is intended to aid in the management of delays due to COVID-19 for all parties in the building, construction and development industry on a proportionate basis.

The purpose of the Contracting Framework is to set out responsible behavioural objectives and principles to guide commercial contractual arrangements materially impacted by COVID-19 for all participants in the building, construction and development industry.

The Contracting Framework is intended to apply to existing contractual arrangements to aid in the management of delays because of unforeseen impacts and commercial disruption caused by the economic impacts of industry and government responses to COVID-19.

The behavioural objectives and principles in the Contracting Framework are based on the view that problems arising from COVID-19 are best resolved by taking a sensible, open and fair approach by all parties to a contractual arrangement including those with capacity to influence the conduct of the direct parties. They aim to assist contracting parties to cooperatively explore solutions and generally avoid the need to exercise termination rights, liquidated damages or initiate costly court proceedings.

This approach involves looking at all the options to see how a problem can first be avoided, consequences minimised, all possible solutions considered and if necessary, agree on a way to share responsibility in a way that is fair and not disproportionate in the circumstances.

Who should use the COVID-19 Contracting Framework

The Contracting Framework should be used by all participants in active contractual arrangements in the building, construction and development industry, and any business, institution, or entity with capacity to impact or influence those participants.

This includes the following parties:

- Clients/Principals
- Head Contractors
- Sub-contractors
- Suppliers
- Banks, financial institutions, or lending entity
- Insurers
- Any other entity with capacity to influence or impact the conduct of an industry participant.

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When does the COVID-19 Contracting Framework apply

The Contracting Framework is applicable to all circumstances involving a delay, or likely delay, which is caused by and directly attributable to COVID-19 and/or any government response to the declared pandemic materially impacting **contractual arrangements entered on or before 1 March 2020**. For the purposes of this Contracting Framework, a likely delay is defined as any circumstance in which it is reasonably foreseen that COVID-19 may impact the capacity of a building, construction or development industry participant to meet a particular obligation established within a contractual agreement or other commercial arrangement.

The Contracting Framework has general application to eligible active contractual arrangements, it is not intended to override any specific support or relief available in the relevant contract, in law or any other legal duties or obligations which a party to a contract is bound to comply.

Contracting behavioural objectives



The Contracting Framework strongly encourages all individuals, businesses and entities in the building, construction and development industry to act responsibly and fairly in performing and enforcing their contracts. This would be achieved by working cooperatively to manage impacts of COVID-19 delays and appropriately balance the interests of impacted parties.

The contracting behavioural objectives of all relevant parties applying this Framework are:

- Share a common interest in working together, to ensure business continuity and to support ongoing safe building and development works throughout the COVID-19 pandemic and during a reasonable recovery period.
- Seek an equitable adjustment or accommodation in contractual arrangements impacted by COVID-19 in preference to escalation to formal disputes.
- Identify and discuss relevant issues resulting in delays due to COVID-19, to negotiate equitable adjustments or accommodations in contractual arrangements, and to work towards achieving mutually satisfactory outcomes.
- Negotiate in good faith.
- Act in an open, honest and transparent manner.
- Provide sufficient and accurate information within the context of discussions and negotiations to achieve agreed outcomes.
- Conduct discussions in a timely and efficient manner.

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- Inform any other relevant participant about this Contracting Framework and its application to discussions regarding the circumstances and ramifications of the COVID-19 delay.
- Ensure that other relevant stakeholders including banks/other financial institutions, suppliers, utility companies, and governments are involved in discussions under this Contracting Framework.
- Assist each other in respective dealings with other stakeholders to achieve outcomes consistent with this Contracting Framework.
- Conduct discussions and all dealings with participants in a manner that is responsible and does not take any unreasonable or unfair advantage of the bargaining power of one party relative to others.
- Ensure that any independent mediation processes or related assistance is pursued in a timely manner and is not undertaken to prolong or frustrate the facilitation of amicable resolution outcomes.
- Ensure that the principles set out in this Contracting Framework have been satisfied before any party pursues any contractual clause or provision that is otherwise available.

Contracting principals



Principals to apply in negotiating and enacting appropriate outcomes between contracting parties, including involvement of indirect parties that can influence conduct or outcomes.

1. If a delay caused by COVID-19 including any government response to the pandemic arises, or is likely to arise, in the context of a contract agreement or commercial arrangement regarding the performance of building, construction or land development works that was entered into prior to 1 March 2020, an entity must immediately advise all parties.
2. The advice should provide:
 - a. a summary of the delay caused, or likely to be caused by COVID-19;
 - b. the steps undertaken to avoid, minimise or address that delay;
 - c. notifying other parties of the existence and application of the Framework to the circumstances;
 - d. include a proposal to facilitate discussions between parties;
 - e. outline any preliminary proposal or approach to minimise any impact of the delay.
3. Discussions between relevant parties should be undertaken wherever practicable within 21 days from the time advice is provided.
4. Parties should focus on the cause of the delay and its attribution to COVID-19.

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5. Once the cause of delay is established or agreed, discussions should aim to reach agreement on a process or other specified arrangement that will enable all relevant parties to handle the delay or minimise any adverse impacts arising from the delay.
6. Any process or arrangement discussed should enable an outcome which can:
 - a. be mutually agreed;
 - b. share responsibility and is not unfairly or unreasonably disproportionate to the circumstances for any party;
 - c. avoid, wherever practicable, adverse outcomes for any party;
 - d. facilitate the ongoing viability of parties throughout COVID-19; and
 - e. enable the efficient, effective and ongoing performance of building, construction or land development works so far as is practicable.
7. If necessary, parties should engage in independent mediation processes overseen by an independent third party to assist responsible, fair and timely discussions and achievement of an outcome that is equitable and proportionate to the circumstances.
8. Allocation of cost should consider the financial situation of parties and their reasonable ability to bear costs for their participation in the mediation process.
9. If the discussions and/or mediation process generate an agreement, it shall be recorded in writing, agreed as enforceable, and remain applicable to the parties for the period agreed.

Further Information

Further information on this COVID-19 Contracting Framework is available from Master Builders Victoria. Contact us on (03) 9411 4555 via email mbassist@mbav.com.au or visit our website: www.mbav.com.au.

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Case Studies of the Application of the COVID-19 Contracting Framework for the Building, Construction and Development Industry

Case Study 1 – Liquidated damages in commercial construction project



RS Building Company is a head contractor working to build a high-rise office block with construction work to the value of \$100 million dollars. RS Building has a contract with the developer (the principal) that required the project to be finished within 2 years, otherwise liquidated damages (LDs) of \$100k per day will apply for every day late.

RS Building has engaged sub-contractors pursuant to subcontract arrangements that also contain liquidated damages provisions reflective of the contract terms made with the developer. One of these subcontractors (subcontractor A) engaged two other specialist subcontractors to perform parts of the job, pursuant to arrangements that also have similarly structured liquidated damages provisions.

Because products needed by one of the specialist subcontractors (specialist subcontractor B) are not available due to COVID-19, they verbally notify subcontractor A of a likely delay. Subcontractor A advises that because the contract is silent on COVID-19 delays, an extension of time will not be granted and that if any delays arise a claim for LD's will be made, because RS Building has advised they will claim LDs on Subcontractor A. This is because RS Building has been advised by the principal that LDs will be claimed if the entire project isn't finished on schedule.

In conventional circumstances, specialist subcontractor B faces the prospects of an LD claim by subcontractor A regardless of whether they had any control of the cause of the delay. Specialist subcontractor B will have to pay the LDs or pursue a challenge through a court action. It is likely that any court proceedings would only involve subcontractor A and specialist subcontractor B, even though it is the conduct of RS builders and the principal which cause subcontractor A to claim for LDs.

Applying the Framework:

- Subcontractor A and specialist subcontractor B have discussions and realise that RS Builder and the principal's insistence on LDs is forcing them down a particular path despite the delay being a directly caused by COVID-19 impacting building supplies.
- Discussions occur with RS Builders who invites the principal to attend, during which it is revealed that the principal was mistakenly advised that LDs must be claimed and there were no other alternative options.
- The principal, upon realising the entirety of the circumstances behind the COVID-19 delay, agrees to not claim LDs against RS Builders and this is recorded in writing.

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- Because RS needs to rely on this written record and be able to enforce it in the future if necessary under the contract arrangements with the principal, they adopt the same arrangement with subcontractor A on the condition that this flows through to any arrangement with specialist subcontractor B.

Case Study 2 – Liquidated damages impact on subcontract



Sammy Mac Builders is a builder engaged to construct a shopping centre with construction work to the value of \$5 million dollars. Sammy Mac Builders has a contract with the shopping centre owner that requires the project to be finished within 10 months, otherwise LDs of \$10k per day will apply for every day late under the head contract. The carpentry subcontract has LDs of \$2k per day for late completion.

The carpenter subcontractor (the carpenter) is delayed in completing the construction of the timber framing for the shopping centre due to physical distancing restrictions and delays to the delivery of feature cladding. As a result, Sammy Mac Builders advises the carpenter subcontractor that it intends to impose LDs for every day that the carpentry trade package is late because Sammy Mac Builders will need to accelerate other trade packages that follow on from the carpenter to ensure that the overall program is not delayed. Additional costs will be incurred by Sammy Mac Builders to accelerate the follow-on work packages as those subcontractors will be entitled to additional costs for accelerating their trade packages.

In conventional circumstances, Sammy Mac Builders will claim LDs against the carpenter because of the additional cost incurred to accelerate other subcontractors that follow on from the carpentry trade work package. Regardless of whether they had any control over the cause of the delay, the carpenter subcontractor will have to pay LDs or pursue a challenge through a court action.

Applying the Framework:

- The carpenter and Sammy Mac Builders have discussions and realise that Sammy Mac Builders is concerned about the late commencement of follow-on trade contractors and the potential impact on the overall construction completion.
- Discussions occur between the carpenter, Sammy Mac Builders and the principal, where the principal indicates it does not have any additional time available between the Date for Practical Completion under the head contract and the commencement of leases for tenants for the shopping centre. If completion is not reached on time, tenants have an option to withdraw from the leases.
- The principal, upon realising the entirety of the circumstances behind the COVID-19 delay, agrees to invite the prospective tenants to a meeting with Sammy Mac Builders, the carpenter, and the critical subcontractors that follow on from the carpenter, to discuss which areas of the shopping centre need to be completed first so that those tenants can open on time and which areas can be delayed because no tenants are currently committed, and construction can continue.

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- As a result:
 - The tenants agree to accept partial completion of the shopping centre as satisfaction of the lease agreement and the leases become unconditional.
 - The principal agrees to the creation of a separable portion in the head contract and to adjust the Date for Practical Completion and LDs applicable to the separable portion and the balance of the head contract.
 - Sammy Mac Builders agrees to amend the overall construction program and the impacted subcontract agreements accordingly and not to claim LDs from the carpenter provided it achieves the revised program and sequencing of the carpentry works.
 - The carpenter agrees to accelerate (at its own cost) the completion of the areas that form part of the separable portion to meet the agreed revised dates and work sequencing.

Case Study 3 – New home under construction



Barry has obtained a \$500k loan from a bank to finance construction of a new home and has engaged Schmitters Builders (Schmitters) to build the home under a building contract. Schmitters has almost completed the construction, been paid for \$300k of work already done, and is due to collect the remaining \$200k when the project is completed.

Barry has lost his job, and the next day the bank advised that his loan was revoked. Barry now needs to find \$200k to pay the builder that he previously thought was available but cannot obtain alternative finance.

In conventional circumstances, Schmitters stops working on the project as they are worried they won't get the final \$200k payment. After speaking with Barry about his payment ability, they commence court action to recover the money, knowing this is unlikely to recoup any loss. Schmitters is also forced to lay off three workers.

Additionally, Schmitters business finance interest rate is increased to reflect increase lending risk because of the extra debt they now carry, and the bank stops access to any future finance. Schmitters is unable to purchase products for three other projects that they have been awarded, creating a need to withdraw from those contracts. One of these contract withdrawals results in commencement of court proceedings and this cost burden puts Schmitters into financial jeopardy and they enter insolvency.

Applying the Framework:

- Before Schmitters and Barry go to court, they have discussions to explore all relevant solutions. Barry says that he intended to pay Schmitters but can't because he lost his job and the bank pulled finance.

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- During discussions, it is revealed that Barry and Schmitters both use the same bank, so they agree to involve the bank in a meeting to discuss financing options.
- The bank is apprised of the full consequences of its decision to pull Barry's finance, and agrees to restore the finance subject to Barry finding another job within three months.
- The bank also agrees to not raise any finance or loan costs to Schmitters and agrees to make good on the business loan facility for the same period, restoring Schmitters capacity to continue its business without any unforeseen delays.
- The agreement is recorded and a range of significant adverse consequences are avoided for both Barry and Schmitters.