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WHITE PAPER

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Construction Projects and Disputes: A Look Beyond the Lockdown, Part III

Even as the world gradually eases out of lockdown, deals are rekindled and services are remobilized, no one doubts that the impact of the pandemic will continue to be felt for months and, some say, possibly years ahead. The impact of COVID-19 on construction projects will vary significantly from jurisdiction to jurisdiction depending on a range of factors, including the severity of the pandemic, the nature and significance of government orders issued to address the virus, and the effect of government action taken to mitigate financial hardships resulting from the virus.

This final part of a three-part White Paper looks in detail beyond the lockdown in three ways. First, what are the lessons learned for future project planning from a contracting, financing, and due diligence perspective? Second, what types of disputes can be expected to arise from the pandemic? Third, what strategies might be employed to weather the storm and minimize the impact of the pandemic on a project and the business of a construction industry participant?

Part I, published on May 1, 2020, set out an overview of some of the recurring issues facing construction industry participants. It sought to convey a global perspective on these issues, as major companies, particularly those with global operations, must have an understanding of the legal challenges presented by the virus to proactively address the challenges it presents across jurisdictions.

Part II, published on May 12, 2020, provided a transactional and disputes-focused overview of the impact of COVID-19 on a select number of key sectors within the construction industry: real estate development, oil and gas, renewable energy, social infrastructure, transportation infrastructure, and telecoms. It also reviewed the typical insurance policies that cover construction projects and how they may or may not apply to a project that suffers financial consequences as a result of COVID-19.

TABLE OF CONTENTS

LESSONS LEARNED AND FUTURE PROJECT PLANNING	1
Project Procurement and Financing	1
Overview	1
Project Procurement, Structuring, and Risk Allocation	2
Procurement	2
Due Diligence and Contingency Planning	2
Project Delivery Model and Pricing	3
Supply Chain Issues	3
Contract Drafting	4
Rebalancing of the Risk Profile and Pricing in New Contracts	5
Cash Flow Issues	5
Financing Issues	6
Commercial Banks and Capital Markets	6
Social Bonds	6
Government Support and PPP or P3 Landscape	7
Spread-On Debt	8
Currency and Exchange Risk	8
Construction Disputes	8
Overview	8
Legal Issues	9
Causation Arguments	9
Constructive Acceleration	9
Cardinal Change	10
Abandonment	11
Mitigation	12
Waiver and Estoppel	12
Claims and Scenarios	13
Projects in Distress and Adjudication	13
Tension Between Contractual Obligations and Nonbinding Government “Guidelines.”	13
Responsibility for Compliance with Guidelines/Regulations and Indemnity for Alleged Failures	14
Resequencing and Changing Work Methods	14
Mobilization and Remobilization	15
Pandemic Costs and the Impact on Existing Claims	15
Basis of Analysis and Concurrency	16
Schedule at Large	17
Disputes by Other Stakeholders	18
Investor–State Disputes	18
STRATEGIES TO RIDE THE STORM	18
Adjustments to Bidding Processes	18
Changes in Risk Allocations May Lead to Upward Pricing Pressure	19
Evaluate the Contracts Closely and Understand the Parties’ Obligations	19
Cash Is King	19
Organize and Monetize Potential Claims in Advance	20
If in Doubt, Notify	20
Be Prepared to Demonstrate What Is and What Is Not Possible	20
Look Outside the Contract	21
Engage and Resolve	21
CONCLUSION	21
AUTHORS	22
ADDITIONAL CONTACTS	22
ENDNOTES	23

Even as the world gradually eases out of lockdown, deals are rekindled and services are remobilized, no one doubts that the impact of the coronavirus pandemic will continue to be felt for months and possibly years ahead. The impact of COVID-19 on construction projects will vary significantly from jurisdiction to jurisdiction depending on a range of factors, including the severity of the pandemic, the nature and significance of government orders issued to address the virus, and the effect of government action taken to mitigate financial hardships resulting from the virus. Further, how owners and contractors respond to the easing of restrictions will be important and may themselves be the source of future claims.

The pandemic raises many issues in the immediate term, the mid-term, and long-term. For that reason, we have prepared this *White Paper* in three parts.

[Part I, published on May 1, 2020](#), provided an overview of the recurring issues relevant to the construction industry, as well as specific legislative and regulatory measures implemented in the countries with the most active energy and infrastructure development programs. Many of our clients are located in these countries, have projects in these countries, or depend on these countries for their supply chain. An overview of these issues and measures in multiple jurisdictions is useful to develop a global, proactive strategy rather than a narrow view confined only to the challenges posed by COVID-19 in the jurisdiction where a specific project is located. The construction industry is a global industry, and the progress of a major project and its timely and successful completion is seldom a function of purely local conditions in the jurisdiction where the project is located. The COVID-19 pandemic has reinforced this reality.

[Part II, published on May 12, 2020](#), provided an overview of the impact of COVID-19 on a number of key sectors within the construction industry: real estate development, oil and gas, renewable energy, social infrastructure, transport infrastructure, and telecommunications. This overview is from both a transactional and disputes perspective and addresses issues of global relevance, including several questions that Jones Day encountered in the few months since the start of the pandemic, from owners, contractors, and design professionals. We also reviewed the typical insurance policies that cover construction projects and how they may or may not apply to a project that suffers financial consequences as a result of COVID-19.

This Part III looks beyond the pandemic in three areas. First, what are the lessons learned for future project planning from a contracting, financing, and due diligence perspective? Second, what types of disputes can be expected to arise from the pandemic? Third, what strategies might be employed to weather the storm and minimize the impact of the pandemic on a project and the business of a construction industry participant? This latter point is important because no matter the bleakness of the present, the industry will survive, and the question is how best to avoid, minimize, and allocate risk associated with the next big challenge.

LESSONS LEARNED AND FUTURE PROJECT PLANNING

Project Procurement and Financing

Overview

The COVID-19 pandemic has created unusual countervailing pressures for project sponsors and governmental granting authorities. On the one hand, resulting supply chain disruptions and liquidity issues for contractors and suppliers have, in some cases, negatively impacted the delivery of construction projects. Effects of these disruptions are also relevant for lenders during the availability period for their financing commitments. We have also seen demand risk projects suffer from acute revenue drop-offs, resulting in downgrades of debt relating to certain projects. On the other hand, national and local governments around the world are promoting infrastructure spending as a method to combat rampant unemployment and address needed investments in their transportation and energy sectors. Governments may also direct funding toward environmental, social, and governance (“ESG”) programs in the furtherance of previously stated goals or in pursuit of new environmental and social objectives after the pandemic subsides.

In light of continued social distancing requirements and an anticipated second wave of COVID-19 infections, we expect to see a number of changes to traditional project bidding processes and emerging trends in contract negotiations to address past and future effects of the pandemic. Lenders, underwriters, and equity investors need to be creative in their financial engineering, and all parties will likely look to governmental and supranational liquidity sources to cover funding gaps. The debt capital markets should continue to be an

accessible source of funding, providing efficient liquidity especially for refinancing solutions on operational projects. Access to reasonably priced funding sources and creative cash flow management will be critically important as projects work their way through the pipeline.

Below we review first some noteworthy issues concerning project procurement, structuring, and risk allocation before considering some key project finance issues of interest to project participants and financing entities.

Project Procurement, Structuring, and Risk Allocation

Procurement. Two issues associated with procurement of construction services in the wake of the pandemic are notable. The first concerns the mechanics of tenders with an anticipated movement to more electronic or virtual procurement processes. The second involves the allocation of risk and pricing of risk.

Most construction and infrastructure projects have traditionally required the physical submission of hard-copy bidding documentation, backed up by electronic submissions for their bidding processes. This is particularly the case for projects that involve government infrastructure, including the separate openings of the technical and financial bidding documents, often in an open style forum (for greater transparency).

While a number of projects in current tendering mode have been suspended during the pandemic, for those projects that are proceeding, we have seen tendering rules being altered to allow for the electronic-only submission of bids and transparent online arrangements for the opening of technical and financial bids on projects. Bidder interactions during the pandemic have also moved to electronic/virtual meetings among owners, government procurers, and bidders. Such arrangements may become more commonplace coming out of the pandemic, even after social distancing restrictions are lifted.

Of course, in different parts of the world and depending on the industry sector, electronic submission of bids and the use of virtual bid rooms and document libraries are normal. This is true for certain projects procured by the public agencies in the United States and private projects in the energy sector. There are project owners who have developed their own internal ability to host virtual procurements, and there are

third-party consulting firms that provide the platforms for such programs. For project owners or developers that must migrate to this approach in the wake of the pandemic, the experience of these owners and consultants can provide practical guidance for managing the virtual tender process.

More nettlesome than the effect on the mechanics of procurement is the issue of prospective risk allocation associated with the impacts of COVID-19 on projects that are being procured before a vaccine is widely available. This is especially so where the impacts of the initial wave of COVID-19 on the industry have not abated and where parties worry about additional impacts caused by a successive wave of the virus. From the owner's perspective, cost certainty is frequently a desired goal. Owners may take the position for new tenders that the risks and impacts of the pandemic should be known and tenders should be able to price that into their bids.

From the contractor's perspective, however, the argument is that the risks are not fully known, and future impacts may not be predictable or priced in a consistent way between bidders. By way of illustration, should a bidder assume that there would be a future shutdown of the project site for a certain period because of a new wave of the virus? Should a bidder assume that a new public health order will be issued increasing workplace social distancing or imposing more rigorous and expensive health measures as a condition of continuing to progress the work? The assumptions made by bidders on such matters can have significant impact on a bid price.

Due Diligence and Contingency Planning. Some commentators have observed that COVID-19 has had a major impact on supply chains within the construction sector, with crippling effects felt on some construction projects. Even when work and travel constraints are lifted and "normal" business returns, many companies will require a long period to recover their operations, some will require restructuring, and others might cease operations entirely. In the post-COVID-19 market, many project principals, lenders, and head contractors will have an increased focus on conducting due diligence over counterparties and the entire supply chain, including subcontractors and material and equipment suppliers. While this should apply to new contractual arrangements, it may also prompt the review of existing counterparties and supply chain links for risks emerging out of the COVID-19 developments.

Key diligence issues will likely include the financial strength, liquidity, and access to credit of counterparties and other entities in the supply chain, and their ability to withstand potential cash-flow interruptions and an increased working capital burden; the extent to which their operations have been temporarily or permanently affected by the pandemic; the continued existence of any movement constraints, quarantine orders, import/export controls, or other restrictions in their places of operation; whether their workforce has returned and the extent of any loss of experience or expertise through changes in their labor pool; and the degree of confidence in their ability to perform on schedule.

Sponsors will not only focus more on their due diligence into counterparties on major projects but also on the entire supply chain as they start to develop contingency plans to address potential future supply chain disruptions. This may include, for example, reserve options for material parts of the supply chain to be located in alternative jurisdictions; advanced purchasing and storage of supplies, equipment, and spare parts; and relocation of fabricating operations to the host country. Project parties may be required to expand their business relationships proactively beyond existing networks to ensure alternative counterparties are available when supply chain interruptions emerge. It may be that a greater diversity of suppliers and jurisdictions of supply will be favored and tenderers with more robust supply chains and developed contingency plans will be favored over alternative tenderers, even potentially lower-cost tenderers. Some owners may require tenderers to provide specifically for execution plans that contemplate various unknown scenarios and for those scenarios to be priced in the tender.

Project Delivery Model and Pricing. At a fundamental level, construction contracts are mechanisms to allocate risk and responsibility between sponsors and contractors for the development of a capital project. In many cases, risks are known, and in others they are not. One party or the other will be viewed as having taken on responsibility for risks that may manifest in predictable and unpredictable circumstances.

The usual project delivery models (e.g., design-bid-build, design-build, engineer-procure-construct (“EPC”), engineer-procure-construct-manage (“EPCM”), and engineer-procure-construct-install (“EPCI”)) each take a different approach to risk and responsibility allocation, and each may be more or

less suited to different projects. For example, in a typical EPC contract where the contractor promises to develop a capital project for a set lump sum price and within a scheduled deadline, the contractor often assumes the risks of delays and increased cost overruns in executing the project, except for some limited and express exceptions where additional time and costs may be claimable.

In the context of the COVID-19 pandemic, parties to current projects have had to reference their contracts to determine which party has been allocated the risk of overcoming the impacts of COVID-19. Where there is no such contractual or other legal relief, the contractor will remain responsible for completion on time and on budget despite any impacts of the pandemic. On the other hand, various contracts have provided relief to a contractor in the form of extensions of time or cost escalations arising from *force majeure* or due to changes in law.

In addition to a greater focus on contract clauses that afford a contractor time and cost protection in light of unexpected risks, it may also be the case that contractors are less willing to take on full EPC risk and responsibility for a lump sum. Contractors may well seek for all or some of the contract scope (especially those aspects more susceptible to unknown risks) to be priced on a reimbursable basis or may also seek to have the project delivered on a more risk-diversified EPCM basis. Contractors may seek greater upfront payments and payment schedules that allow for a positive cash flow, whereas owners will be more likely to require greater security and retentions and to defer more payment to the latter end of project delivery, where possible. All of these issues will ultimately be impacted by the length and depth of the pandemic going forward, general market conditions, bargaining power as between owners and contractors at the time of contract negotiations, and other issues.

Supply Chain Issues. Supply chain management is a critical component in successfully developing and constructing a project within time and cost budgets. The COVID-19 pandemic has highlighted potential weak links in supply chains that may previously have gone unnoticed. As described above, we expect project principals to pay increased attention in the due diligence phase on the robustness of existing supply chains for their current and future projects and to develop contingency plans to address future disruptions. In some cases,

there may be vertical integration, where major EPC contractors seek to take control of certain aspects of the supply chain and in other cases a greater diversification of the supply chain.

Quarantine restrictions and travel restraints, both cross-border and internal, may result in a premium being placed on locally sourced material and labor compared to imported goods and an expatriate workforce. Some countries have already initiated moves to consolidate and build domestic construction and supply capabilities in response to the current pandemic, so that businesses and domestic economies are less reliant on cross-border movements, less exposed to external disruptions, and more self-reliant when they resume operations. By way of illustration, India is reported to have taken steps to set aside land for new factories to manufacture solar cells and modules, batteries, and other equipment required to develop renewable energy projects, to reduce its reliance on supplies from China.

Supply chain issues will also drive structuring and sequencing decisions for projects involving components from Mexico. Significant impacts will be felt from the COVID-19 measures enacted by the Mexican government limiting activity to “essential” businesses combined with the new U.S.–Mexico trade agreement (“USMCA”), which takes effect on July 1, 2020. Establishing the “essential” nature of facilities that manufacture final products or components for export has presented a particular challenge because this legislation is unclear regarding exporting industries and the supply chain classification for essential businesses. The gap in the lifting of restrictions on activity and differences in the “essential” business definition between the United States and Mexico may generate a disruption in the supply chain, as Mexican facilities may not be allowed to reopen while the United States and other countries resume operations with a potential shortage of components and raw materials from Mexico.

All of this will result in greater scrutiny by owners and contractors into subcontractors and suppliers, as well as the physical location of supplies. We also expect increased focus by financing entities on the creditworthiness of major suppliers and subcontractors during the negotiation and disbursement phases.

Contract Drafting. In the context of agreeing on new contracts, initial attention has primarily focused on modifying *force majeure* clauses to provide certainty of relief by expressly

listing epidemics, quarantine, and travel restrictions, or to specifically exclude them, as part of a negotiated risk allocation. This should not be problematic in many common-law jurisdictions, which generally allow parties substantial freedom to agree to the scope of *force majeure* provisions. Civil law jurisdictions, however, vary in practice, and statutory provisions in some countries may be mandatory. Expressly stating that epidemics, quarantine, and travel restrictions can give rise to *force majeure* relief may be of little immediate assistance, in respect of COVID-19, if relief also hinges on the event or its effects being unforeseeable. In those jurisdictions where parties are allowed to provide for contractual relief regardless of foreseeability, this element may be the subject of negotiation.

Parties can instead look to other provisions that might not be negated by foreseeability. Change in law provisions that operate separately from *force majeure* events can allow an extension of time, or pass-through of costs, or a commitment to negotiate a resolution, where government-imposed restrictions affect performance. Such epidemic-related events could also be included as an excusable delay giving rise to an extension of time for performance, even if the existence of the epidemic is known and its potential impact foreseeable. Whether a cost adjustment might also apply would be a separate point to be agreed.

The extent and duration of interference caused by an epidemic, quarantine, or travel restriction can be significant and difficult to predict, while full performance depending on the circumstances could be expected quickly once restrictions are lifted. Parties might therefore consider extending the period that performance may be suspended for an excusable delay, and for *force majeure*, at least in respect of such epidemic-related events, before a party has the right to terminate. From an owner’s perspective, the need for a right to terminate based on a *force majeure* event may not be as important where the contract, as is often the case, affords the owner the right to terminate for convenience.

Within the context of a project finance transaction, material adverse change (“MAC”) provisions have significant implications for developers, lenders, and contractors. During the construction period when there are outstanding loan commitments, the existence of a material adverse change could impact the ability of the developer/borrower to obtain loan disbursements if it is unable to make a clean representation

to the lenders as to the absence of any MAC. During this loan availability period, lenders could refuse to fund loan disbursements in this circumstance. We expect this dynamic to generate increased friction in the negotiations around conditions precedent to loan disbursements.

Explicit exclusion of epidemics and pandemics from the MAC definition is increasingly common in publicly filed deals since the outbreak occurred, and borrowers will push harder to exclude prospects and financial performance from the definition. Prospects and financial performance are sometimes included in the MAC definition when the parties define what things are adversely affected. From a borrower's perspective, "prospects" and "financial performance" are vague and forward-looking, and the borrower will therefore fight to exclude these concepts from the definition. MAC defaults will continue to appear in some project finance credit documents, the practical outcome of which will be a leverage point in renegotiations during the remedy phase where a MAC has been declared.

Rebalancing of the Risk Profile and Pricing in New Contracts.

Drafters and parties to new project contracts need to be mindful, and adequately address the consequences, of COVID-19 in *force majeure* clauses and, generally, in risk allocation and pricing. *Force majeure* is generally invoked to excuse a party's performance under a contract, and usually applies through a local law statute and/or contractual provisions. In most cases, the existence of *force majeure* suspends performance of a party's obligations without penalty, effectively shifting the risk allocation of the contract. In the first few weeks after the start of the COVID-19 pandemic, project parties and their lawyers rushed to analyze whether the crisis and its attendant restrictions fit under the applicable *force majeure* framework of their project. Key elements in this analysis have been whether the pandemic was supervening (i.e., did not predate contract formation) and reasonably unforeseeable at the time of contracting, as well as whether the pandemic caused the impediment to performance or was caused by some other factor. Again, we expect *force majeure* analysis to be a critical element of negotiations in the coming months.

The effects of the COVID-19 pandemic will linger for months, and some claim they will extend possibly years, likely ebbing and flowing and thereby potentially causing uneven, wave-like impositions of restrictions to mobility and potential disruptions

to supply chains. Project parties must therefore bear in mind that the "supervening and unforeseeable" requirement may be more difficult to meet for new contracts signed after COVID-19 became a pandemic. Specifically crafted language may need to be drafted to address more completely the lingering effects of the pandemic. All parties must carefully analyze the risk profile and the pricing structure of the project contracts to address any ongoing impact of the COVID-19 situation, including adjusting the risk allocation, the project scheduling, and the procurement processes. Specific assumption by the EPC contractor or supplier of these types of risks will likely result in pricing increases across all types of contracts (fixed-price, cost-plus, etc.).

Cash Flow Issues. All project counterparties including developers, contractors, subcontractors, and lenders to existing projects have had to deal with some difficult financial decisions resulting from the COVID-19 pandemic. Putting aside any potential *force majeure* or other claims for relief that may be asserted, contractors and subcontractors who have been unable to meet the construction timeline risk having their performance bonds or financial guarantees called upon by the project owner. Project sponsors and borrowers are encountering difficulty in drawing down on existing project loan facilities to meet their capex and working capital requirements in the face of lenders tightening their funding requirements, including invoking MAC provisions or declaring potential defaults as a result of the pandemic.

There have been situations where contractors in compliance with the construction milestone have yet to receive payment from a project sponsor as funds have dried up due to the sponsor prioritizing other payments. On existing projects, some sponsors who are finding it difficult to draw down on their existing facilities are considering refinancing with other lenders or having their debt restructured to convert part or all of the outstanding debt to equity. Lender appetite for these restructuring solutions has been uneven in the face of the uncertainty surrounding the pandemic and the potential length of its impact on the sector.

For projects in the pipeline, we are seeing more requests by project counterparties regarding security payment structures and financial guarantees, particularly on large projects and those that are subject to a tender process. Some project sponsors (including government entities) are now requiring

that contractors and subcontractors put up higher amounts of performance security, as well as specific requirements regarding the liquidity of the security.

For example, in addition to guarantees for performance parameters and defect liability periods, contractors have also been asked to provide upfront liquid security of up to 20% of the entire contract value. In Asia for example, some project sponsors are requiring that corporate guarantees and security bonds be replaced by on demand, unconditional, and irrevocable liquid bank guarantees to secure contractor non-performance. As a result, some bidders and contractors are also requiring that project sponsors secure their milestone payments through a bank guarantee on a rolling basis as opposed to a corporate guarantee.

Due to these changing dynamics and the requirement of the various interested project parties to secure financial obligations, we generally expect overall project costs to increase (significantly, in some cases). These circumstances could also provide opportunities for nontraditional project lenders to provide the required financial security to these project parties at different pricing levels. Given the estimated funding required for these new projects, we expect the financial markets to evolve and develop new structures and products to deal with some of these issues.

Financing Issues

Commercial Banks and Capital Markets. The economic effects of COVID-19 are creating liquidity constraints on the global financial markets. Certain financial institutions and project debt have been downgraded across a number of jurisdictions, directly impacting financing options for developers. While commercial bank lenders will likely continue doing business with creditworthy borrowers and relationship clients, the uncertainties in the commercial debt market may lead to liquidity shortfalls for construction projects in the short term. Local financial institutions and project developers may start to look to development finance institutions (“DFIs”) to provide liquidity and address financing gaps. Most DFIs have expressed a commitment to assist in protecting the investments of their existing clients. The economic crisis may also require DFIs to assume more risk than usual in response to requests to lend into jurisdictions that are more volatile.

As access to project finance loans has decreased, issuers of corporate and project bonds have regularly used the capital markets to refinance existing debt or to repurchase outstanding bonds trading below par. In addition, long-term concession projects with current bank (commercial and DFI) financing in place under mini-permanent (“mini-perm”) structures continue to look for capital markets refinancing solutions. The medium- and long-term creditworthiness of counterparties to these agreements (governmental entities and private off-takers alike) will affect pricing and marketing of these debt securities. As restrictions continue into summer 2020, the long-term effects of the resulting economic downturn may create additional downward pressure on ratings and upward pressure on interest rates for project bonds.

Many governments will push infrastructure investment as a means to stimulate employment after the effects of the pandemic have subsided, leaving the long-term outlook cautiously positive. The mitigation measures being adopted during this period by both commercial bank lenders and DFIs will likely affect the structuring of financing deals in the future.

Social Bonds. As described earlier in this paper, the access to new project finance loans on the scale or terms available prior to the COVID-19 pandemic is expected to be limited. The COVID-19 crisis has resulted in a credit-strained market, with governments, supranational entities, and commercial banks unable to fund the post-COVID-19 economic recovery on their own. In addition, there has been increased focus on poverty, hunger, unemployment, and mental and other health issues due to the significant negative social impact of the pandemic. With private financing needed to fill the gap, sustainable bonds (in particular social bonds) have emerged as a relevant tool to finance much-needed social infrastructure. With continued pressure on the commercial banks, sponsors of construction projects are expected to turn to the institutional project bond market to fund new projects, particularly social infrastructure projects that enhance resiliency and provide positive social outcomes. In the aftermath of the pandemic, investors may start looking for additional opportunities to increase their ESG investments. For an institutional bond investor, social bonds offer an opportunity to back an emerging class of assets.

Since the beginning of the COVID-19 pandemic, issuances of social bonds have increased dramatically, reaching US\$33 billion by the end of April 2020. Most issuances have

been by supranational organizations such as the International Financing Corporation, the African Development Bank, Nordic Investment Bank, and the European Investment Bank. They have all targeted the effects of the coronavirus pandemic. As we emerge from the pandemic, more issuances of social bonds by corporate and project sponsors are expected for the financing of major energy and infrastructure projects.

Government Support and PPP or P3 Landscape. The commercial bank market may not offer sufficient liquidity at economic pricing levels to satisfy funding demands in the post-COVID-19 construction and project finance markets. Some expect increased financial involvement by governments in the promotion of private participation in the infrastructure and energy sectors to help fill this funding gap, as well as promoting construction-related job growth.

During the last financial crisis, we experienced an increased level of governmental support for the financing of national interest type projects. Refinancing guarantees were offered by some governments (we saw these on infrastructure public-private-partnership (“PPP” or “P3”) projects in Australia and Singapore, in particular). It is possible some governments may look at ways they could support important, but otherwise commercially nonviable, projects to get off the ground. Some governments may also look to support options available for certain nationally important projects they want to proceed, notwithstanding the current pandemic and a slowing down of lending. Support options may include refinancing guarantees, government pays or availability payment-type mechanisms, capital grants, and viability gap funding approaches. We are aware of several projects in developing infrastructure jurisdictions where bidding is proceeding but on the basis of viability gap funding support to be provided by the relevant procuring authorities.

In the United States, some federal funds have already been committed to this exercise. The International Development Finance Corporation (“DFC”) began operations in 2020, combining and improving the existing development finance functions of the Overseas Private Investment Corporation (“OPIC”) and USAID’s Development Credit Authority. DFC currently has an investment cap of US\$60 billion and offers new financial tools such as equity investments, technical assistance, and

feasibility studies to more proactively address development needs. In the United States, there is proposed legislation that would authorize approximately US\$20 billion in new federal spending over the next three years aimed at improving water infrastructure.

PPP may be a form of public procurement that will be used by some public-sector bodies to further promote projects in important national sectors. In Asia, so far demand risk infrastructure projects have remained the norm for PPP procurements. Just as may be the case in the United States, it is possible that some governments will look to promote projects that can be funded through availability payment-type schemes rather than direct payments from users.

As noted above, such government pays schemes are often considered better for overall bankability than projects where demand risk is fully passed to the private sector and its lenders. In the United States, we have seen downgrades for multiple demand-risk projects. Sponsor and investor appetite for these types of projects will be affected after the final revenue impact from the COVID-19 pandemic is realized. Traffic declines of 70-80% on tolled highways could cause these demand-risk projects to access debt service reserve accounts for their next principal and interest payment and may result in distressed situations if traffic levels do not pick up prior to the subsequent debt service payment date.

We expect the availability payment PPP concessions to attract the highest levels of interest in the mid-term, with investors and lenders closely focusing on the ratings of granting authorities. Appropriation risk will also require heightened analysis, as tax revenues have fallen across all jurisdictions and the construction market experiences increased demand for smaller amounts of public funds.

The erosion of tax revenue as a result of the pandemic can be expected to have an impact not just on PPP projects but traditional public works projects funded by tax revenue. This is true at the national or federal level, the state or province level, and the city or county level. The Governor of California, a state that has the fifth-largest economy in the world, is projecting a budget deficit of US\$54 billion, and the City of Los Angeles is projecting a budget shortfall of several hundred million dollars.

Shortfalls of this magnitude can be expected to impact the timing of public works even as governments contemplate deficit spending to stimulate the economy.

Construction and developer clients should remain apprised of available direct-funding schemes, tax-advantaged financing solutions, and increased government financial support for PPP and energy projects. We are constantly monitoring these programs around the world and expect increased opportunities for contractors and sponsors to avail themselves of innovative government-supported funding solutions.

Spread-On Debt. Debt pricing is one of the most important considerations for infrastructure projects undergoing current bidding. Spreads are growing, and lenders are finding it harder in this market to price risk, especially where it might involve user-pays models or even reliance on government-type payments (for example, what might be seen on a social infrastructure project). Bidders who retain an ability to still obtain firm (even if in-principle only) commitments for financing bids have a clear advantage in this current market and into the near future. Pricing may be higher for projects in the shorter to medium term, both in terms of debt financing implications but also where sponsors are financing more of their own investments into infrastructure projects than might have been the case pre-pandemic.

For projects that require upfront financing, there is no “one size fits all” or specific “market precedent” for project leverage ratios, as globally there are differences from region to region, jurisdiction to jurisdiction, and project to project, based on structure, risk allocation, and the experience and credit-worthiness of the parties. In developing-infrastructure jurisdictions, such as Asia or Latin America, it would be unusual to see higher debt-to-equity ratios than 80:20, though this has occurred in some more-developed infrastructure markets. It is possible that coming out of the current pandemic, new projects may have to look at lower gearing ratios for construction financing to get projects off the ground.

Currency and Exchange Risk. The COVID-19 pandemic has wreaked havoc on currencies in emerging markets. Unprecedented fast-tracked foreign exchange moves caused (whether by the pandemic or other factors), to give a few examples, the Brazilian real to fall 23% against the U.S. dollar

since the beginning of 2020, while in the same period the Turkish lira is down nearly 14% and the South African rand has lost 32%.

A developer may receive international funding in U.S. dollars or some other hard currency, while the project's revenues are often denominated in local currency. This creates a potential asset/liability mismatch, as devaluation increases the developer's local currency liability for international payment obligations. Another layer of complexity is added by foreign exchange restrictions that could impact the developer's ability to service its debt, and such measures have been taken before by unstable governments facing financial crises. Similarly, devaluation could adversely affect the developer's working capital needs if it impacts the supply chain and causes the developer to need more local currency to buy the same offshore supplies.

Cross-border project financings have always faced the possibility of exchange-rate risk, but the wide-scale devaluation landscape exacerbated, if not brought on, by the COVID-19 pandemic has created anxiety across a number of jurisdictions. We expect these issues to take a more prominent role in structuring and documenting project financings going forward. Lenders will generally not accept currency risk, and governments and procurement agencies also tend not to, at least to any meaningful degree. Local currency swaps and other derivative instruments will become more widely used and increased use of natural hedges (by aligning a part of the project's revenue currency with the financing currency) may occur. The insufficiency of local currency financing may force governments to accept a higher share of this risk by, for example, indexing project revenues to a fixed exchange rate.

Construction Disputes

Overview

There will be several key disputes to be resolved on major construction projects as work continues in the wake of the COVID-19 pandemic.

The claims that are most likely to manifest into formal disputes will be multifaceted. For instance, the question of whether the pandemic is a *force majeure* event will likely be tested in the courts and in arbitrations, and no doubt parties will mount

imaginative arguments to assert their positions. In some cases, the answer should be reasonably clear from the contract itself, and in other cases, the answer may be more opaque.

Clauses dealing with *force majeure*, suspension, change in law, termination, and extension of time will be at the heart of disputes, but the outcome will often depend on circumstances where more than one clause is activated or is relevant, where the underlying facts are complex, and where a series of steps is required in order to seek relief and one or both parties have not complied with those requirements to the letter. Contractors and owners may assess whether other clauses might apply and afford or preclude relief, such as provisions dealing with emergencies, health and safety clauses, and site access.

Unsurprisingly, we have not seen many disputes formalize as yet. Stakeholders to projects are now in the process of assessing the impact of the pandemic and are taking steps to manage or mitigate the immediate effects, such as site shutdowns, reduced workforces, resequencing, and so on. Only in the next six to 12 months (the time period will be dependent on the project schedule and many other factors) will the consequences of whatever contractual or common-law levers stakeholders have pulled, or not pulled, be revealed. At that point, disputes will undoubtedly start to progress.

This discussion is divided into two parts. First, we highlight some of the underlying legal issues that are likely to come into play when pandemic-related construction claims are made. Second, we look at some specific claims, factual scenarios, and practical considerations that stakeholders should examine when preparing themselves to bring or defend COVID-19 disputes.

Legal Issues

Causation Arguments. One of the most important legal questions that companies face when assessing liability in the construction sector is causation. The burden of proof will invariably rest with the asserting party to show that the “trigger event” has caused loss, prevented or hindered performance of the contract, or made performance impossible or impracticable. The threshold the party seeking to rely on the relevant contract clause must overcome varies. In relation to causation, an affected party might have to show that the event is the operative cause of the impediment. Alternatively, it may be

enough for the event merely to have contributed substantially to the occurrence of the event, such that while it is among the concurrent causes, the nonperformance might have occurred without it. In many jurisdictions, it would be consistent with judicial tendency to interpret relief-based clauses restrictively and require a party seeking to obtain the relief identified in the provision to demonstrate that it would have been willing and able to perform the contract “but for” the force majeure event.

Furthermore, the length of the chain of causation may be particularly relevant in the context of this pandemic. The following hypothetical domino effect might apply to the coal industry. The current pandemic lessens demand for new cars and other steel products. This may then cause steel mills to reduce production, which may reduce the need for coking coal, which then results in fewer shipments, potentially diverting coking coal to power plants, thereby reducing thermal coal sales. The point at which the pandemic impact (direct or indirect) is felt in this hypothetical reverberates through the chain. Taking the chain of events into account, the core question is whether a party relying on a contractual provision can establish legal and factual causation.

Constructive Acceleration. Where an owner denies a contractor a request for a time extension related to the pandemic or simply fails to act on a request for such an extension, a contractor may attempt to assert a constructive acceleration claim. Under a constructive acceleration claim, a contractor seeks to recover its acceleration costs incurred to complete a project by the applicable completion deadline rather than an extended completion deadline.

Federal and state courts in the United States have formulated the elements that must be established to state a claim for constructive acceleration. One case set forth five elements that a contractor must show to establish a constructive acceleration claim: (1) the contractor encountered an excusable delay; (2) the contractor made a timely and sufficient request for an extension of the contract schedule; (3) the owner denied the contractor’s request or failed to act on it within a reasonable time; (4) the owner insisted on completion of the contract within a period shorter than the period to which it would be entitled by taking into account the period of excusable delay, after which the contractor notified the owner that it regarded the alleged order to accelerate as a constructive change in

the contract; and (5) the contractor was required to expend extra resources to compensate for the lost time and remain on schedule.¹

Not all jurisdictions and not all countries recognize constructive acceleration claims. However, even where the governing law does not recognize constructive accelerations claims per se, similar types of relief might be available under another theory.

In all events, contractors and owners should keep in mind several points related to potential constructive acceleration claims arising out of the pandemic. From the owner's perspective, it is important to be cognizant of the potential for such claims. This is especially so since a constructive acceleration claim has the potential to transform a time-only claim (e.g., where a contract provides a time extension only for a *force majeure* event) into a claim for monetary relief. Likewise, owners should insist that contractors provide the contractually required support for any requested time extensions (e.g., time impact analysis) so that the owner can make a timely assessment of the propriety of the requested time extension.

From the contractor's perspective, a constructive acceleration argument is one avenue to transform what might otherwise be a claim solely for time into a claim for additional compensation. Additionally, a contractor will increase the likelihood of a successful constructive acceleration claim where it takes the following steps: (i) document entitlement to the extension; (ii) provide timely notice to the owner of the request for extension; (iii) clearly communicate that the contractor considers any denial of or delay in responding to a request for a time extension as a constructive order to accelerate; and (iv) document the additional resources expended to maintain the schedule that would not have been incurred had a time extension been granted. Failing to take each of these steps will provide the owner with additional arguments that a contractor will have to overcome to establish its claim to recover the amounts to which it is entitled. By way of illustration, if the contractor does not provide timely notice of the request for an extension as required under the contract, the owner will likely assert this as a defense, and the contractor will have to argue that failure to provide timely notice was somehow excused.

Cardinal Change. Some contractors may attempt to seek relief for COVID-19 impacts based on a cardinal change theory. A

cardinal change is a change that is "so drastic that it effectively requires the contractor to perform duties materially different from" those in the original contract.² This construct is recognized in a number of jurisdictions.³ In the United States, the cardinal change doctrine was developed to provide relief on federal government contracts. However, the law in a number of states now recognizes this form of relief, including on private works contracts.

The successful assertion of a cardinal change has a few different potential consequences. One potential consequence is that the owner is determined to be in breach of the contract. Such a finding may permit the contractor to terminate the contract. Additionally, under certain circumstances, a court might deem the contract to have been abandoned and permit a contractor who continues to perform in the face of a cardinal change to recover reasonable compensation. This could have the effect of essentially negating the price certainty of a fixed price contract and converting it into something more akin to a cost-plus contract, something that would be contrary to the expectations of the owner.

A number of hurdles must be overcome to prevail on a cardinal change theory. For one, a question will exist as to whether the additional costs and delays associated with COVID-19 are imposed by the owner and whether that is a requirement to recover on such a theory. For another, the contractor will have to establish that the change is so significant that it is not something that can be addressed under the contract.

Because contractors fear that courts will be skeptical of claims for cardinal changes, contractors are not quick to assert such claims. It is rare for a contractor to place all of its eggs in the cardinal change basket and far more common for this theory of relief to be pursued as an alternative theory in conjunction with other theories like *force majeure* or change in law. Due to the risk that a cardinal change argument could convert a fixed-price contract to a cost-plus contract, owners need to mount a stout defense to such claims and not assume that it will automatically be dismissed.

A case decided on April 22, 2020, by the United States Civilian Board of Contract Appeals ("CBCA"), *Pernix Serka Joint Venture v. Department of State*, CBCA No. 5683, highlights the challenges of prevailing on a cardinal change theory. In that case, the contractor contracted with the U.S. Department of

State (“DOS”) to construct a rainwater capture and storage system for a fixed price in Freetown, Sierra Leone. The Ebola outbreak reached Sierra Leone in July 2014. On August 8, 2014, the World Health Organization declared the outbreak of Ebola to be an “International public health emergency.” With flights being cancelled and contractor and subcontractor personnel asking to leave the country, the contractor directed that the project be shut down and all personnel be evacuated out of the country. The contractor had sought direction from DOS, which declined to direct the contractor and left the decision to the contractor. The contractor did not remobilize to the project until March 2015, approximately seven months later.

The contractor submitted a request for equitable adjustment for more than 10% of the original contract price for the additional life and health safety costs and disruption of the work, including the need to demobilize and remobilize at the work site. While the applicable excusable delay clause from the Federal Acquisition Regulations provided for a time extension for “epidemics,” “acts of God,” and “quarantine restrictions,” it did not provide for compensation. Nonetheless, the contractor contended that the failure of DOS to provide guidance or direction and requiring the contractor’s return to the project site with added life safety measures constituted a cardinal change entitling the contractor to additional compensation.

The CBCA rejected the contractor’s argument and granted the government summary judgment, stating: “Despite the difficulties encountered during the Ebola outbreak, [DOS] never changed the description of work it expected from the contractor. Throughout communications with [contractor], [DOS] repeatedly stated that it could not give directions to the contractor on how it should respond to the ongoing outbreak, instead leaving decisions solely in the hands of the contractor. Any changes in conditions surrounding the performance of the contract arose from the outbreak and the host country’s reaction to the outbreak. This situation forced [contractor] to reevaluate how it wished to proceed with the work outlined in the contract. Throughout the situation, [DOS] informed [contractor], on multiple occasions, that it would not order [contractor] to evacuate the site and that [contractor] must make its own business choices as to whether it needed to demobilize from the site.” The CBCA reiterated: “Here, the work required of [contractor] was detailed in the contract. The addition of life safety measures after remobilization did not alter the nature of

the thing it had contracted for; the contractor remained obligated to perform at the fixed price.”

Abandonment. The law in many jurisdictions recognizes the doctrine of abandonment. The notion of abandonment is much broader than the situation where a contractor simply stops showing up at the project (which itself is a material breach). In general, abandonment, in a broader context, is determined by some courts based on two factors: (i) the extent to which the work actually performed by the contractor differed from the work contemplated under the original contract; and (ii) the extent to which the parties followed the procedures relating to changes in the work. Under this theory, some courts allow contractors to recover the reasonable value of all of its work. Thus, as with the cardinal change doctrine, abandonment can effectively remove the price certainty afforded owners by a fixed-price contract. The facts that may support an argument of abandonment may overlap with the facts used to support a cardinal change argument.

There are some published state court decisions where the failure of the parties to follow the change order procedure for dealing with extra work supported a determination of abandonment. For this reason, owners need to be careful not to take steps that result in abandonment of the change order process. By way of illustration, if an owner told a contractor to hold off submitting its requests for changes until the end of the project, notwithstanding contract language requiring notices of the grounds for such changes be given within a fixed period of time from the circumstance warranting a request for change, a contractor might later use this to support an argument of abandonment.

While this may overlap with waiver and estoppel concepts, the consequences of abandonment are far greater for an owner than a mere finding that the owner has waived its right to reject a request for change or a claim due to a contractor’s failure to give timely notice. Owners should therefore carefully document any deviations from contract procedure that guards against a broader abandonment argument by, for example, indicating that the contract is affirmed and remains in effect. For owners, it will be important to not inadvertently provide a contractor with additional ammunition to somehow support recovery of its costs for responding to the pandemic where no such relief is provided under the terms of the contract.

Mitigation. In most cases, a condition precedent to any *force majeure* entitlement is satisfying an implied or express duty to mitigate. The language used in each contract will critically impact the content and scope of the mitigation duty. For example, “best endeavors” will likely create a higher standard than the words “usual” or “reasonable” “endeavors.” Where no duty to mitigate is expressly provided in a clause entitling a claimant to relief for *force majeure*, a duty will usually be implied. It follows that where a contractor is seeking schedule relief based on alleged *force majeure* arising from COVID-19, it will likely be an accepted position on the part of both claimant and respondent (or contractor and owner) that the onus is on the contractor who is seeking relief to demonstrate that it has fulfilled its duty to mitigate the claimed impact of the *force majeure* event. The question that will arise is, what must the claimant do to meet its duty to mitigate?

While the bar in some jurisdictions has previously been interpreted as being relatively low (for example, steps to avoid increasing one’s own loss), there is an emerging view that a claimant’s duty to mitigate is more onerous. In English law, for instance, the recent case of *Seadrill Ghana Operations Limited v Tullow Ghana Limited*⁴ concerned the effect of a mitigation obligation to avoid, overcome, or circumvent the consequences of a *force majeure* event in relation to a long-term contract for Seadrill’s West Leo semi-submersible drilling rig. The court decided that in order to establish the duty to mitigate in each case: (i) one must look at the specific words in the contract as well as the factual circumstances of each case; and (ii) a party asserting *force majeure* must not only take steps to avoid its own loss, but also must consider impacts to the other party.

A party asserting *force majeure* may need to show that there were no reasonable steps that could have been taken to avoid the impact of the *force majeure* event. The inherent uncertainty as to what steps are reasonable, as well as the consequences of this issue to liability (i.e., the need to have taken all or appropriate reasonable steps as a “gateway” to entitlement or successful assertion of *force majeure* as a defense), will provide scope for a difference of opinion between the parties that will contribute to the prospect of a formalized dispute between the parties.

Waiver and Estoppel. Waiver and estoppel doctrines often enter into complex construction disputes when the parties’

actions do not match the terms of the contract. Waiver, in broad strokes, relieves a party of a contractual obligation. Waiver can be express or implied. Where a party expressly waives an obligation, there may be little dispute about the fact of the waiver. However, disputes frequently arise as to the scope of express waivers. An implied waiver may be based upon a party’s conduct indicating that it intended to ignore (or at least failed to enforce) an obligation. This often comes up in combination with arguments over whether notice provisions have been modified or waived.

For example, when a contractor fails to timely present a notice of claim or request for change order under the terms of the contract, but the owner allows the claim and evaluates it on the merits, the contractor may argue that this creates a waiver of certain presentment defenses. Such arguments have been made when a contractor fails to provide timely notice of a *force majeure* claim. Whether such arguments are successful may hinge on the governing law and the terms of the contract.

A similar issue may arise in connection with contractual requirements mandating that notices from the contractor be provided in writing. Contractors who fail to formally comply with written notice requirements may argue that the owner somehow waived the written notice requirement, that oral notice suffices, or that, in the absence of prejudice to the owner, actual or constructive notice of the *force majeure* event or claim should suffice. Again, the outcome of such arguments will depend on the facts and the governing law.

A related issue concerns whether waiver of a notice or written notice requirement in connection with one claim or *force majeure* event results in waiver of such requirements as to later claims or *force majeure* events and the effect of “anti-waiver” clauses. Given the circumstances of COVID-19, the prudent course of conduct is for parties to construction contracts to openly communicate about the challenges of the pandemic and to guard against actions that may result in unintended waiver or modification of contractual provisions.

In contrast to waiver, which relieves a party from an obligation (e.g., providing written notice), estoppel may prevent one party from improperly benefitting from conduct it induced another party to take or not take. Estoppel may prevent a party from asserting its counterparty’s failure to abide by a term of the contract where the counterparty reasonably relied

to its detriment on words or acts of a party. Contractors frequently assert this doctrine when they do not give formal written notice of a claim or *force majeure* event within the time prescribed by the contract where the owner's representatives are alleged to have told the contractor to defer submitting formal notices for various reasons.

Similarly, contractors may argue estoppel where extra work is performed at the request of the owner without prior written authorization or without formalizing a construction directive or change order. The outcome of such arguments may depend on the wording of the contract, the governing law, and the particular facts and circumstances.

Again, contractors may contend that new or different work methods may be required as a result of COVID-19. Contractors should be careful to timely submit claims and comply with contract requirements to avoid the risk that a waiver or estoppel argument will not suffice or take steps to document the facts and circumstance supporting any waiver or estoppel argument. Owners too should be careful to require compliance with contract requirements and to avoid unintended waiver of, or estoppel precluding application of, notice, change order, and claim requirements.

Claims and Scenarios

Projects in Distress and Adjudication. An inevitable consequence of the global economic recession that this pandemic is likely to cause is an unfortunate increase in the number of insolvencies in the construction industry among certain classes of owners, contractors, and subcontractors. The slim profit margins on which many contractors and subcontractors operate, combined with low capital reserves and cash flow dependency, particularly at the small/medium contractor end of the market, means a likely significant adverse and more immediate impact on the construction industry, as even compared to other industries. The insolvency of the main contractor on a project is high on the doomsday scenario planning for most developers, and this focus has increased given recent events.

There are clearly a multitude of legal and practical issues that arise, aside from just the basic contractual processes that need to be followed in such a scenario. This may include, for example, protective measures, notifications, and issues relating to: bonds and guarantees (whether on-demand or

conditional), draws on letters of credit posted as performance security, the preservation of rights against an insolvent party's partners, or title ownership of goods and materials on or off site. Similarly, lenders are assessing potential breaches of loan covenants, recourse under sponsor guarantees that may come into play and considering the potential legal, commercial, and technical complications of exercising "step-in" rights, which may accrue, to enable build-out of half-completed borrower assets, alongside their wider enforcement rights.

For contractors in jurisdictions⁵ with security of payment and statutory adjudication legislation (legislation that provides a statutory right to receive regular interim payments and commence an adjudication in respect of payment disputes that provides a comparatively quick decision and payment of the amount the adjudicator determines due), we are already seeing an uptick in claims and adjudications and expect this trend to continue. Security of payment legislation is specifically designed to protect cash flow of contractors.

Considering the pressure on contractors, it is unlikely that disputes over payment will be put off until the end of the project; instead, we anticipate continued and growing adjudication activity in these jurisdictions. We also expect to see early and frequent triggering of dispute clauses in an attempt to ventilate issues throughout the execution of projects.

It is likely that all project participants will monitor the solvency of other participants closely and ensure all contractual and statutory rights designed to protect against insolvency of a participant are used to ensure payment and performance.

Tension Between Contractual Obligations and Nonbinding Government "Guidelines." Many governments have published nonbinding guidance on safe working in construction. While many construction contracts will specifically set out which party bears the risk of changes in law, it would be unusual for a contract to engage expressly with the consequences of nonbinding guidance issued by public agencies that do not have the force of law (in contrast to formal regulations adopted by an agency under enabling legislation). Contractors who decide to follow nonbinding guidance and intend to seek time or money from the owner need to consider how best to frame the implementation of nonbinding guidelines to enhance the likelihood of obtaining relief.

For instance, a contractor may frame compliance with such requirements as complying with general (and legally binding) obligations or being tantamount to new conditions to being able to proceed with the work. On the other hand, owners and contractors should be cautious about directing contractors or subcontractors to implement nonbinding government guidance without considering whether such a direction will enliven a time or cost entitlement that otherwise would not have existed. Owners and contractors should also be mindful that subcontractors or suppliers based in different jurisdictions may be subject to different return-to-work guidelines, which may or may not be binding on them.

Responsibility for Compliance with Guidelines/Regulations and Indemnity for Alleged Failures. In addition to considering how owners and contractors can best implement any necessary COVID-19 guidelines and requirements, such parties should also consider how the contract may allocate responsibility for both ensuring compliance and assuming liability for any failures. While parties to construction contracts may intend to work collaboratively to implement COVID-19 guidelines and requirements, all parties should be prepared for failures or even merely the allegation of failures, particularly from third parties. Such allegations could come from individuals (or their next of kin) who claim they contracted COVID-19 as a result of the conditions on the jobsite, as well as from governmental authorities acting on the basis of site inspections or anonymous tips. In all such cases, an understanding of the division of responsibilities between owner and contractor is key.

First, the owner and contractor should understand which of them has responsibility for ensuring compliance with every necessary measure. Many owners may assume that the contractor is completely responsible, but this is likely an oversimplification. While the contractor may control the activities of its own workers during the performance of their work, there are myriad other locations and situations where an owner may need to properly manage or delegate its responsibilities (separate contractors performing simultaneous works, shared site spaces, jobsite entry and exit locations, project-wide food services, etc.). Moreover, even where contractors are entirely responsible, it may be advisable for owners to require the contractor to track and report on compliance. In addition to work stoppages or bad publicity that could result from poor compliance, in some jurisdictions a lackadaisical approach to

overseeing contractor compliance could lead to suits or fines directly against the owner.

Second, regardless of perfect compliance, suits by third parties may be inevitable. Workers who contract COVID-19 may allege that the infection occurred onsite and perhaps as a result of alleged noncompliance with governmental guidelines. Even if such claims are covered by workers' compensation or similar schemes, family members of workers who are sickened may still have viable claims. These claims may be impacted by the passage of legislation designed to eliminate, limit, or otherwise affect such claims, as has been discussed in many jurisdictions. To avoid disputes between owner and contractor, parties should understand (and clarify if necessary) which party has defense and indemnity obligations for such claims and in which circumstances. Indeed, understanding these responsibilities may further encourage vigilance among the parties in ensuring and documenting the steps taken to comply with applicable measures.

Resequencing and Changing Work Methods. In a typical design-and-build contract, a contractor will usually be responsible for: (i) deciding how (within the parameters set by the contract) to perform the work that it has been contracted to perform; and (ii) providing adequate resources to complete that work by the prescribed completion date(s).

Many contractors have taken the position that the pandemic or governmental orders issued in response to the pandemic have necessitated changes in construction methodologies and resourcing plans for the foreseeable future, including professional distancing requirements directing that workers keep a safe distance away from each other. A number of contractors have argued that, to comply with such orders, the number of people who can be deployed to particular work fronts has to be reduced and this would therefore cause delay and disruption. The fact that these guidelines will change over time will further complicate parties' attempts to implement them.

Contractors and owners will—at least in theory—share an interest in keeping projects on time and on budget despite these guidelines. To the extent possible, both should take a collaborative approach to managing the impact of such requirements. At the same time, parties should protect themselves by reviewing how their contracts allocate responsibility

for managing these sorts of issues and what adjustments to the contract, if any, might be warranted. In particular, parties should determine whether performance of any particular obligation—like, for instance, hand delivery of a notice—has been made impossible or impractical and whether the parties should agree on an alternative means of notice (e.g., by email with a special subject line designation for communications being made in lieu of hand delivery).

Mobilization and Remobilization. On many projects, contractors will maintain that there may be further delays to completion or progress due to slow remobilization of labor, particularly migrant labor. Contractors may also seek to document and attribute delay due to ongoing workplace social distancing measures, which contractors will argue inevitably affect the rate of mobilization of the workforce in the site camps and the productivity of the workforce.

The impacted contractor might try to wield a *force majeure* clause as both a shield and a sword to protect against claims by the owner for liquidated damages or delay damages and as a sword to obtain additional compensation. However, depending on the contract and jurisdiction, the contractor may find the protection afforded by the *force majeure* provisions for COVID-19-related claims to obtain an extension of time, assuming that the pandemic qualifies as a *force majeure* event and other requirements that might apply, like unforeseeability, can be satisfied.

For these reasons, contractors will seek redress to obtain extensions of time and/or additional compensation under other provisions of the contract. At least three provisions could be the basis for contractor claims:

- **Change in Law.** A change in law provision often entitles the contractor to time and money. However, triggering this clause may lead to a debate around what constitutes a change in law under the contract. For example, do governmental recommendations and guidance fall within such a definition? If the change in law is not precisely defined in the contract, arguments will be made as to what does and does not fall within the scope of the change in law provision. The answer will largely depend on the language of the change of law provision, the governing law, and the nature of the orders issued by governmental authorities. A contractor will have a stronger argument where the government issues a mandatory order (e.g., shutting down construction or mandating

certain health and safety measures as a condition of permitting construction to resume or continue) and a more challenging argument where the contractor is voluntarily complying with nonbinding guidance.

- **Access to the Site.** Normally the availability of the site access falls under the owner's obligation. For instance, contractors may seek to shift the responsibility for delay and extra costs to the owner for lack of site access, or restrictive measures taken by public authorities impacting entry of site areas or traveling to and from site. Owners may contend that they have made the site available and that the contractor is responsible for complying with legal requirements concerning access. In some cases, owners may themselves advance *force majeure* arguments to excuse their performance.
- **Health, Safety, and Environmental Provisions.** These provisions often require work to stop where there is a real and present, or imminent, risk to safety. Often such provisions play in the owner's favor because they exclude claims for damages in cases where there is a requirement to stop the work for safety reasons.

It can be challenging to mitigate the mobilization problems in the present circumstances, especially in light of travel restrictions. Part of the solution may be to resort as much as possible to local contractors or suppliers. Indeed, our experience is that international contractors are seeking to subcontract work in this way.

Pandemic Costs and the Impact on Existing Claims. An issue that will arise when the wave of claims from this pandemic start to take hold is whether a contractor can claim: (i) costs arising from the pandemic; and/or (ii) increased prolongation costs. The answers to these questions typically depend on the provisions of the contract, the law governing the contract, and when during the project the additional costs were incurred. The following scenarios illustrate how these questions might arise.

Scenario No. 1: Assume that the project at issue has a substantial completion date that was already overrun because of the owner's culpable events, and during that period of overrun, the contractor incurred further costs related to the pandemic. The pandemic in this instance causes no further delay. The contractor has already notified the owner of its claim for an extension of time and money (i.e., compensable delay), but the pandemic cannot be categorized as a *force majeure* event (because, for instance, the *force majeure* clause provides

an exhaustive list of events that may be classified as *force majeure*, and the pandemic does not fit any of the categories on that list). The parties may need to consider things like the impact of a but-for causation test on the analysis, an assessment of entitlement on a “fair” or “fair and reasonable” basis, and which contract language often makes the test to be applied for costs arising from delays.

Scenario No. 2: In this scenario, the project has suffered delays to the completion date because of owner-culpable events, and again the project schedule is overrun as a result. The contractor is *prima facie* entitled to time and money as a consequence of that delay (i.e., compensable delay) and provides notice of its claim. There is then an event (the pandemic) that falls within the scope of the *force majeure* clause and that in and of itself causes further delay to completion, in addition to that attributable to the owner-culpable events. In this second scenario, the owner issues the *force majeure* notice, and the *force majeure* clause entitles the contractor to time only. The parties will again need to consider the impact of a causation analysis on the entitlement, but also whether the *force majeure* event affects entitlement to compensation. The owner may contend that, since the *force majeure* event is expressed as a neutral event that does not provide a monetary entitlement, the *force majeure* event acts as a supervening event that overrides the contractor’s entitlement under the extension of time provisions, and the contractor is therefore not entitled to compensation.

Alternatively, it might be argued that the contractor cannot claim costs that cannot be causally connected to the original delay, so while the contractor may be able to claim the costs of the entire delay period, costs such as demobilization and remobilization from site or repatriation are costs that are causally connected to the *force majeure* event, which under the hypothetical contract does not entitle the contractor to monetary recovery. The language of the contract may (or may not) make clear which (if either) of these alternatives applies or may not specifically address this scenario.

Scenario No. 3: A further scenario may be where the owner-culpable delay occurs during the project, and not in a period of overrun, as in the first two scenarios. The question is whether the contractor is entitled to its costs for the period of the owner-culpable delay and the *force majeure* period. Unlike the scenario where the project is already overrun by virtue of

the owner-culpable delay and it was pushed into a period of *force majeure*, during the currency of the project, the *force majeure* event would have been encountered in any event, irrespective of whether or not the project was in delay at that point. As a result, it might be argued that the contractor would get the extension of time but would not receive compensation.

Basis of Analysis and Concurrency. Relevant to any analysis of delay is the basis upon which the delay analysis is carried out and the question of concurrency. Consider a further scenario whereby a pandemic occurs, it falls within the contract definition of a *force majeure* event, and it causes delay to completion because, for instance, labor does not appear at site. A notice is issued by the contractor. The *force majeure* event provides for an extension of time to the contractor but no compensation (i.e., noncompensable delay). While the *force majeure* event is ongoing, the government takes regulatory action to enable social distancing due to the *force majeure* event, and that causes further delay to completion. The contractor gives notice pursuant to a change in law clause. Assume that the contract provides that this type of new or change in government regulation is an event entitling the contractor to an extension of time *and* money (i.e., compensable delay). The pandemic ceases (in that normalcy is restored and people go back to work), but the government regulation continues for the foreseeable future, causing further delay.

In this scenario, there are three periods of delay to consider. Period 1, the *force majeure* period. Period 2, the *force majeure* and government regulation period. And period 3, the government regulation period.

Taking this scenario in isolation and subject as always to the applicable law and the contractual terms, the entitlement in periods 1 and 3 may be relatively straightforward. The contractor is entitled to time for period 1 because the only consideration is a *force majeure* event, and that is a time-only entitlement under the terms of the hypothetical contract. The contractor will receive time and money for period 3, assuming it can establish causation, prove its loss, demonstrate it has mitigated, and so on, because the government intervention is a time-and-money entitlement under the terms of the hypothetical contract.

Period 2 is arguably less clear. The contractor will argue that it is entitled to time and money because it triggered the change

in law clause. The owner will likely argue that there is a time-only entitlement by virtue of the competing events, or that the *force majeure* event overrides the government intervention. Unless the contract expressly addresses this scenario, as some but not all contracts do, the contractor and the owner may take opposite positions.

Since period 2 involves two delay events occurring, at least partly, over the same time, a preliminary consideration might be the law of concurrent delay. For example, two components that are often required in order for there to be concurrency are: (i) two events causing delay (usually but not necessarily to completion); and (ii) where one is a contractor-culpable event and the other is (typically) an owner-culpable event. The timing of delay and the “potency” of the delays may also be relevant (see below). In many jurisdictions, absent contrary contractual language, the contractor will receive an extension of time but no prolongation costs.

However, the scenario outlined above is different. There are two events, but both are neutral as far as party culpability is concerned. One gives a time-only entitlement, and the other gives time-and-money entitlement. That said, on the basis that one event allocates, as a matter of risk, time *and* money, and the other, as a matter of risk, allocates time only, the owner may argue that it is appropriate to extend the more common outcome that attaches to concurrency to this scenario (i.e., time only).

Turning to the issue of the timing of delays, period 2 in the above scenario concerns a period of “overlap”— that is, the period from when the government intervention starts and the *force majeure* stops. However, both delays do not start at the same time. An often-debated question is whether concurrency can arise during a period of “overlap.” One argument is that it can because both delays are effective causes of delay, and each of them would cause delay to completion. Depending on the applicable law, that may be an appropriate analysis. An alternative view is that overlapping delays can never be concurrent, because the second delay, in this case the delay caused by the government intervention, is “theoretical” and the first-in time event should be the one that prevails. If that rationale applies, there would not be concurrency in period 2, because the *force majeure* event giving time only was the first-in time event.

With respect to the question of potency, in some jurisdictions, events need to be of equal “potency” in order to be concurrent. In others, it is sufficient for them to be “effective” causes of delay. If equal potency is the test, for instance, in the above scenario, the *force majeure* event stops all work because there is no labor onsite, whereas the social distancing merely makes the work less efficient. On a potency analysis, therefore, the delay caused by the government intervention would be subordinate to the *force majeure* event. This assessment might be different if the *force majeure* event results only in a reduction of the labor force rather than a total loss of the labor force.

The answer may be affected further by whether a prospective or retrospective analysis is carried out, and whether the periods of delay are determinable in duration or indeterminate. With a prospective analysis, at the start of the *force majeure* period, week by week, or day by day, the program would be updated and would show the *force majeure* event as critical. However, a retrospective delay analysis invariably shows a different outcome than a prospective analysis. Furthermore, where the event is determinable in duration and can therefore be impacted onto the schedule in its entirety, will that present a different outcome where the event is indeterminable and cannot be similarly impacted? In all events, forensic scheduling experts will be able to work with counsel for either the owner or the contractor and the parties themselves to assess the ability to undertake these different methods of analyses and their implications.

Schedule at Large. Depending on the location of the project, the actions of governmental authorities where the project is located, and other considerations, the schedule of the project may be negatively impacted. The obvious situation is where, due to a stay-at-home order of a government authority, construction may not proceed for an extended period of time. When the order is lifted, what happens to the project schedule?

Many contracts will have provisions that provide for how the contract completion deadlines are to be adjusted via a time extension. The situations can be more complicated. One risk is that, unless the time for completion is clearly reestablished, a contractor may argue that the schedule has somehow been put at large—i.e., that the work need only be completed

within a reasonable period of time. As stated by the California Supreme Court in a case involving the construction of a hotel that was interrupted after the 1906 San Francisco earthquake and ensuing fire: “[T]he time of performance even when it is made of the essence, if it is once waived, sets the matter at large, and another date for performance can only be fixed by a definite notice, or by conduct equivalent thereto.”⁶

Disputes by Other Stakeholders. Construction disputes flowing from this COVID-19 pandemic will not be confined to sponsor/contractor/supply chain/professional team relationships but will involve, and sometimes be driven by, the other stakeholder arrangements. More complex projects will usually have myriad complicated interfacing arrangements, from the end user/tenant requirements to agreements with local authorities, utility and transport operators, and other public or quasi-public bodies, to funding arrangements with debt and equity providers.

These agreements will each contain various construction obligations related to the works, together with milestone/completion requirements. The economic pressures across sectors will provide a backdrop that will foster disputes across these relationships. For example, the dramatic adverse effect to areas of real estate such as retail and hospitality may lead some prospective tenants to seriously consider the financial viability of their future leasing space. Where such arrangements are contingent on property owner procured works, there is likely to be particular focus on, and potential dispute over, such obligations, which will consequently have the effect of involving contractors who have “back-to-back” arrangements. As such, disputes are likely to flow from the economic tensions in wider stakeholder relationships, each of whom will be trying to protect their position in this new economic climate, potentially creating a “domino” effect of involving contractors and other professionals. In addition, where arrangements are not back-to-back, a party in this chain may find itself with stranded liability that may not be passed up or down the contractual chain.

Investor–State Disputes. Many governments are attempting in good faith to strike a balance between the protection of public health and economic interests. However, certain governments may use the COVID-19 pandemic as a pretext to expropriate projects opportunistically, terminate concessions (e.g., because of a lack of funds or interest), or otherwise abuse the rights of foreign investors.

COVID-19 may also be used to escape an unpopular deal. For example, Constellation Brands, the company that makes Corona beer, has had a US\$1.4 billion project for the construction of a major brewery cancelled by the Mexican government. President Lopez-Obrador, who had long opposed the brewery, cancelled the project due to the results of a local referendum called in late March 2020 in the midst of the COVID-19 quarantine, in which 3,000 voters of a possible million participated.

There are more than 3,000 investment treaties in force that provide international legal protection to foreign investments. These treaties offer broad legal protections that may not be available under the local law of the host country, and that can supplement the investor’s rights under any contracts governing the investment. To enforce these substantive legal protections, most investment treaties also provide for investor–state dispute settlement, which allows investors to initiate international arbitration proceedings directly against the host state of the investment in the event of a dispute.

Government measures that are unreasonable, disproportionate, arbitrary, or discriminatory may trigger valid investment treaty claims by construction companies.

STRATEGIES TO RIDE THE STORM

The previous sections have identified a series of procurement, contracting, and financing issues that have come about or have been exacerbated by the pandemic that may affect the way in which future projects are planned. We also addressed what legal issues and scenarios stakeholders might encounter as part of claims that the owner or contractor formalize in due course. Taking into consideration all of those issues, this section provides some thoughts on strategies that participants to construction projects may wish to consider in order to place them in the best possible position in the months that lie ahead.

Adjustments to Bidding Processes

The procurement and bidding issues addressed earlier in this paper present challenges to both owners and contractors as new projects are procured in the near term and in the mid-term. Neither owners nor contractors are well schooled in epidemiology or in predicting whether and when the next wave of the virus may hit. How is this to be factored into bids? If

bidders make overly conservative assumptions, owners may end up overpaying for services if the contingencies underlying such assumptions do not occur. If bidders simply assume that nothing more restrictive than the status quo will persist, a second wave that results in government-ordered shutdown of the project for an extended period of time, labor and supply disruption, and increased costs for health measures may make it uneconomical for the successful bidder to complete the project. If rosy assumptions made about the future course of the virus turn out to be unwarranted, successful bidders may be challenged to finish projects.

The language of the contract and how it allocates the risk of such developments will be important, and the increased attention on risk allocation clauses, including *force majeure* clauses, is discussed above. But those involved in ongoing tenders may struggle with very basic questions about how bids should be priced in light of the uncertainties of the future course of the pandemic and the response to such developments.

In many respects, this goes beyond generic contract clauses and goes to the assumptions that owners may or may not want bidders to make when responding to a tender with respect to the cloud of the pandemic and what assumptions contractors are or are not willing to make when submitting bids. Adapting traditional approaches like allowances (for cost or time) or cost and productivity adjustments for new COVID-19 impacts (e.g., more restrictive government orders) have been explored. As is always the case, the devil is in the detail, and there are challenges to defining what qualifies for a charge against an allowance or warrants a cost or time adjustment. We expect participants in construction procurements to struggle to find workable solutions to the challenges of estimating and bidding in the face of a virus that cannot be scheduled like many construction activities, where a sound basis exists for planned durations.

Changes in Risk Allocations May Lead to Upward Pricing Pressure

EPC prices can be expected to increase if contractors are asked to assume increased supply chain risk. Pricing will also trend higher if contractors and suppliers are required to provide higher levels of more liquid security for their obligations. Spreads on construction debt are widening, and traditional funding sources will likely be insufficient to cover the demand

for construction financing. Increased construction costs and increased debt costs will tend to drive up tender prices. In most cases, governments and granting authorities will have the strongest balance sheets and should be in a position to assume many of the risks driving the pricing increases. We expect more involvement by governments in the design-build sector as well as assuming more funding obligations through utilization of availability payment PPP schemes. In the situations where a local government may not be in the position to directly assume these risks, export credit agencies and multi-lateral funding institutions may be requested to bridge the gap.

Evaluate the Contracts Closely and Understand the Parties' Obligations

Where a *force majeure* provision allows limited time extensions and the reason for the extension is over (the laws change back, labor is allowed to return to the jobsite, or something similar), the obligations imposed by many construction contracts are restored. Parties must think strategically about disputes that may arise following a *force majeure* event, including considering all applicable provisions. What notice is required in the case of additional delay? If remedial work is necessary, how must it be documented according to the contract? Has a right been waived, or a new obligation imposed, by the parties' conduct? How is price escalation addressed? Are there specific terms that governed any suspension? And these are only the tip of the iceberg. Evaluation of the contract as a whole and how the provisions may apply following a *force majeure* event is key to moving forward on any project.

Cash Is King

As the construction sector emerges from forced work stoppages and the social distancing restrictions of the COVID-19 pandemic, access to funding and supply chain components will present the most immediate concerns, together with cash management issues applicable to owners, contractors, and subcontractors. Every party—from the minor subcontractor and supplier to the major subcontractor, contractor, and owner—is feeling the liquidity pinch from months of inactivity. Layer on top of that the potential funding obstacles for owners from some wary lenders, and we may be witness to a series of painful negotiations (and potentially disputes) up and down the project delivery chain. We expect the most creditworthy contractors and owners to maintain their access to funds from

banks and through the capital markets. We also foresee the need for creative financial engineering for some small balance sheet players to get through the liquidity shortage caused by the COVID-19 pandemic.

Organize and Monetize Potential Claims in Advance

Organizing and monetizing anticipated claims early assists in the inevitable negotiations of what will, or will not, be modified based on the circumstances. Bucketing labor costs, materials/equipment costs, and schedule or time impacts and analyzing the costs for delay, disruption, or acceleration helps frame what positions to take in those negotiations. Key steps include: (i) close and careful communications with project managers; (ii) establishing a record of documentary evidence; and (iii) sticking to your strategy. While many contracts allow for time extensions for a *force majeure* event only, quantifying the long-term impact through an evaluation of other clauses and organization of additional amounts to be incurred is a key consideration for any contractor. For owners, the same analysis is needed to be prepared to directly address any such claim.

If in Doubt, Notify

The vast majority of contracts will require a notice to be issued in respect of clauses that give rise to some form of additional entitlement. Many of those clauses will require the notice to be issued within a certain period of time, and some of those may bar the entitlement that would otherwise be due if a timely notice is not issued. Depending on the terms of the contract, the law, and the circumstances, there may be ways to overcome a failure to strictly satisfy the notice provisions. It may be possible to argue that notice was not required because the notification required pursuant to the clause should in fact have come from the other party. It might be possible to argue that the parties had established a practice of exercising their rights under a particular provision without complying with the notice provisions. It could be that one of the parties made representations that the notification provision would not be relied on or that one of the parties knew about the event(s) that were the subject of the claims.

However, where the contract is a well-drafted, sophisticated instrument, these arguments are usually difficult. Therefore, a party should always err on the side of caution where it

considers that it may possibly have a claim pursuant to a clause in the contract and give a notice in a sufficient level of detail to satisfy the contractual requirement. If it transpires that on further investigation, the notification under a provision is not credible in law or in fact, then the notifying party need not pursue it further, but failure to give notice at all can lead to draconian consequences.

Be Prepared to Demonstrate What Is and What Is Not Possible

Earlier in this paper, we mentioned that relief may be available only for those obligations that have in fact been prevented or delayed, and that there is a common law and, usually, a contractual obligation to mitigate. Rather than assume that there is a moratorium on all works, owners and contractors should carefully evaluate whether they are under an obligation to continue works and, if so, to what extent. If it is possible to continue the procurement of materials, the placing of orders, or the carrying out of design, there may be an obligation to carry on. However, if this is not possible, then the reasons should be documented very clearly. It will be advisable to have a paper trail of the measures taken.

For example, where a party is procuring goods from a foreign jurisdiction where there are no restrictions, and those goods are due to be shipped to a different jurisdiction where there are restrictions, has a party sought an exemption from those restrictions so that it can fulfill its obligations? Has it carefully checked whether the activity it wishes to perform is restricted or has been mandated by the government as an essential activity? When a dispute arises, the contractor will be in a better position if it can show it has done what it was not prevented from doing. Is it possible to demonstrate, for instance, that the works could not be re-sequenced or re-resourced so that other works are advanced? That may be a necessary step under the terms of the contract and, if it is not done, may preclude an extension of time and prolongation entitlement that would otherwise be due.

Look Outside the Contract

Most countries have experienced some form of lockdown, which has been implemented with varying degrees of severity and has lasted for different periods of time. For all of those countries, there has been an exemption list for certain types

of industries or operations (e.g., “essential services”). The sheer volume, length, complexity, and sometimes inconsistency of the announcements, guidelines, and regulations are overwhelming, and, of course, many of them are not to be found in the specific words of the contract. What is more, by virtue of the geographical reach of some organizations and the number of countries in which they have projects, or upon which they are reliant for the supply of goods, it is necessary to track and decipher COVID-19-related legislation and communications across a number of jurisdictions.

This tracking exercise is important both to ensure compliance with the terms of the contract—most contracts have provisions that require compliance with local laws and legislation—and also to take advantage of any relaxations, concessions, or exemptions that may be available. Not only may a project or sector be exempt from lockdown measures but also, for example, companies may be able to benefit from financial relaxations. These may include accelerating the payment of invoices, certifying future interim payments where work has not been done based on previous valuations, increasing the frequency or order of payments, making advance payments, and so on. Jones Day is tracking the announcements in states or jurisdictions that we consider to be of importance to our clients so that we are able to give our clients real-time, multi-jurisdictional advice on regulations and measures as they are put in place, and advise clients how best to respond to those measures.

Engage and Resolve

The contract, in theory, creates a platform of certainty allowing parties to organize and plan. However, so much of the focus in contracts is on risk consequence—what happens when things go wrong. If one asks lawyers the sorts of issues that tend to be negotiated the most on project contracts, the usual sorts of issues arise: limitation on liability issues, indemnities, price, termination provisions, etc.

However, if one asks the project team what are the things that are the most important if they are thinking about success on a project, that list is very different: reaching and maintaining consensus on scope, having clarity as to the responsibility of the parties, and good communication lines. In other words, in the eyes of the project team, what drives success on projects

is relationships, underlying governance, and transparency, not the management of risk consequence.

When it comes to success, it is the people and the relationships. If the true extent of the impact of COVID-19 is known to the other party, then perhaps that knowledge will precipitate a mediated outcome that would not have been available had the parties retreated to their contractual trenches. Perhaps one of the key secrets to navigating through the pandemic is to focus on exercising the governance structures within the contract that deal with the environment and the communication lines between the parties. Those structures and communication lines should encourage multi-level engagement, not just between two individual client representatives but also between teams and organizations. While contracts may not have anticipated the extent of the impact that COVID-19 brings to bear, what the parties can do is use contractual and extra-contractual frameworks to communicate issues and try to resolve them.

CONCLUSION

COVID-19 has and continues to have the most significant and widespread economic impact since the Second World War. There is no benchmark against which to react to what is happening or to accurately assess what the medium- to long-term impact will be. Nevertheless, with input on these papers from more than 40 attorneys across 25 offices of the Firm, we have sought to provide detailed insight into the reaction of different jurisdictions and construction sectors to the pandemic, the availability of insurance to respond to the direct and indirect impacts being felt, and, in this final part, a thorough review of the issues and scenarios we see arising in the medium- to long-term in procurement, project structuring, financing, and disputes.

Virtually no participant in the construction industry will escape some degree of negative impact. However, those owners and contractors that invest time in workshopping the issues that will affect them from every angle, and that work hard to develop strategies to tackle those issues, will be the ones that emerge from this snap recession period the least scathed. They will be the ones that have placed themselves in the best position to thrive once the world moves beyond the lockdown.

We hope that this three-part *White Paper* is of assistance in addressing the present challenges and planning for future success. Jones Day is available to provide legal guidance as the construction industry navigates through the short-term, mid-term, and long-term implications of the pandemic.

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ENDNOTES

- ¹ *Fraser Constr. Co. v. United States*, 384 F.3d 1354, 1361 (Fed. Cir. 2004).
- ² *Krygoski Construction Co. v. United States*, 94 F.3d 1537, 1543 (Fed. Cir. 1996).
- ³ In English law, for instance, the seminal case often cited is *Thorn v London Corp* (1876) 1 App. Cas. 120.
- ⁴ [2018] EWHC 1640 (Comm).
- ⁵ Australia, Canada, Isle of Man, Ireland, Malaysia, New Zealand, Singapore, and the United Kingdom.
- ⁶ *American-Hawaiian Eng'g & Constr. Co. v. Butler*, 165 Cal. 497, 519 (1913).

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