

Demand Without Supply: Preparing for Supply Chain Issues on Construction Projects

June 23, 2020

By , and James De Melo, Student-at-Law

Construction is now an essential workplace, and although all work is allowed to start or continue, it is not business as usual. The continuing local and global effects of the COVID-19 pandemic create ongoing challenges for construction sites regarding health and safety, logistics, delays, and disruptions to supply chains. Given the current environment, it may be difficult or impossible to obtain necessary materials and equipment on time or at pre-COVID-19 prices. This can result in unanticipated delays and cost increases which parties to construction projects may be unable to absorb due to tight project schedules and profit margins.

Properly resolving supply chain issues—whether from the perspective of an owner, contractor, subcontractor, or a supplier—will often require a two-pronged approach focusing on both the legal entitlements and obligations of the parties, as well as a consideration of some more practical steps. There is no “one size fits all” approach that will apply to every supply chain issue, but regardless of your role on a construction project, the ideas discussed below represent some helpful starting points which may assist in the resolution of supply chain disruptions.

Review your Contracts

A good starting point for any potential dispute on a construction project, including supply chain issues, is to refer back to the terms of the contracts for the project or supply. For construction issues, the contract is often paramount, so most construction disputes eventually will require reference to the terms of your agreements even if matters do not progress to litigation. In fact, having a clear sense of both your rights and obligations under your contracts can often serve as the best way to avoid being dragged into time-consuming and costly litigation.

Bearing this in mind, in the event of a potential supply chain disruption, parties should consider reviewing their contracts with a particular focus on the following types of provisions:

1. **Force majeure clauses:** As we previously discussed in more detail [here](#), a force majeure clause may relieve a party from performance of some or all of its obligations under a contract upon the occurrence of an unforeseeable event outside of the control of the parties. To rely on a force majeure clause, a party should be prepared to establish a causal link between the unforeseen event and the inability to perform the contractual obligations. In the current circumstances, parties will want to pay particular attention to whether their force majeure clause includes wording extending its application to disease, pandemic, epidemic, or other similar events. However, force majeure clauses do not excuse parties from the consequences of their own actions and they do not entitle parties to refuse to perform their obligations upon the occurrence of reasonably foreseeable events.
2. **Indemnification provisions:** Indemnification clauses can be used to allocate risks from one party to another on the basis of an agreement between the parties. As they relate to supplier contracts, indemnification provisions can be used to pre-emptively determine who bears the risk for price increases or the cost of delays resulting from the unavailability of equipment and

materials. Parties should review their construction contracts and supply agreements to determine if the risk of supply chain issues has been allocated to a specific party or parties, or to determine if other risk allocation tools have been used.

3. **Notice Provisions:** Where a party responsible for supplying materials or equipment becomes aware of a potential delay in delivery or increase in price for equipment or materials, the contract may require the party to give notice within a specific time and in a specific form. As we have previously discussed in more detail [here](#), claims clauses in contracts often have specific procedural and substantive requirements and a claim for increased compensation or extension of time may be denied if the requirements are not met.

In addition to the above, owners, contractors, and suppliers should review supply contracts for continued feasibility in light of delays caused by COVID-19. Many ongoing construction projects have experienced delays due to the virus and, as such, particular caution should be paid to the current validity of price commitments. It is typical for supplier contract pricing to be contingent on supplying materials within a particular timeframe and originally-agreed prices may have become unfeasible due to changes in availability and market pricing. All aspects of the construction contract framework, including purchase orders, proposals, general conditions, and specific or supplementary conditions should be reviewed to determine if the parties have agreed to a process for resolving issues caused by delays or price changes.

When reviewing supply agreements, it is important to be aware of the relationship between contract documents. For example, depending on the specific terms agreed to, the terms of a purchase order may exclude prior proposals, quotations, or communications between the parties, or may incorporate other documents or terms and conditions. These relationships are especially important to keep in mind where one document says yes while the other says no. Special care must be given to understanding the unique circumstances of each specific agreement before decisions are made.

Consider the Doctrine of Frustration

If your construction contract does not contain a force majeure provision, parties may consider the potential applicability of the legal doctrine of frustration to supply chain issues caused by COVID-19. Put simply, frustration is a general principle governing construction contracts which may be invoked when contractual obligations become impossible to perform through no fault of either party. Where frustration applies, the consequences are severe. Both parties are discharged from further performance of the contract with no further obligations to one another.

The law imposes a high bar on frustration with a standard of *impossibility* of performance. It is unlikely that increased costs of supply or difficulty meeting supply deadlines would be sufficient. It may be possible to establish that a supply agreement is frustrated if, for example, the material to be supplied can only be sourced from one country, but the government has suspended trade with that country due to COVID-19. Even in this example, if the material can be sourced from an alternate location, frustration likely would not apply even if supply became more expensive or would be delayed as a result.

Relying on the doctrine of frustration always comes with the risk that the other party to the contract will view the termination as improper and claim damages to compensate for increased costs or delays incurred in finding a replacement. As such, claiming frustration always comes with the risk of a court award of damages for improper termination, in addition to litigation costs.

In contracts between large, sophisticated companies which do not contain a force majeure clause or any other language dealing with COVID-19 related issues, courts may interpret these absences as intentional—which is to say that the courts may consider that the parties agreed to have the supplier supply materials no matter what.

Although fairly simple in concept, specific applications of the doctrine of frustration can be quite complex and each unique set of circumstances must be independently considered with legal advice before the doctrine is relied on. It is not sufficient to simply point to the state of emergency or the epidemic itself and purport to rely on frustration on that basis.

Plan to take Practical Steps

Aside from contractual or legal arguments, proactive owners, contractors, subcontractors, and suppliers should give consideration to a number of practical realities of construction work during the COVID-19 epidemic and its aftermath. This will include reviewing essential project timelines and milestones to determine what levels of delay and costs can be absorbed before critical issues begin to accrue. Working backwards from this point, owners and contractors will need to take steps to ensure that potential supply chain disruptions are pre-emptively addressed to avoid reaching critical levels of delay or untenable and unbudgeted materials costs.

This may require reaching out to key suppliers (and as an owner or general contractor, all sub-contractors) to determine what their actual ability to deliver materials is and potentially re-working planned project workflows and schedules to accord with the availability of materials. Additionally, planning for increased prices in materials may require parties to discuss increased supply budgets or the possibility of change orders and additional purchase orders to allow material costs to better reflect the realities of market pricing.

Alternatively, for projects which still have some flexibility with respect to choice of suppliers, owners and contractors should make efforts to diversify suppliers. This will limit the potential impacts of a localized outbreak of the virus which shuts down a crucial supplier and will allow projects to proceed notwithstanding the issues of any one supplier or region. Diversification should be considered a particularly important tool for projects which rely on critical or unique components to progress. By taking these steps before issues arise, proactive owners and contractors can mitigate the impact of potential delays caused by supply chain issues by reorganizing plans around the reality of current supply chain conditions.

Suppliers, similarly, will want to review their actual capabilities and provide notice of any anticipated logistical or production related issues. Providing prompt notice of anticipated issues will not only help maintain relationships with owners and contractors, but may allow for disruptions to be planned around and resolved without resort to costly litigation. Just as is the case for owners and contractors, suppliers' construction contracts too may contain applicable force majeure provisions or notice requirements.

For assistance with any of these steps, including a review of your construction contracts and discussions on the potential applicability of the doctrine of frustration to your situation, please contact [Faren Bogach](#) or [Paul Conrod](#).

The information and comments herein are for the general information of the reader and are not intended as advice or opinion to be relied upon in relation to any particular circumstances. For particular application of the law to specific situations, the reader should seek professional advice.

For more information or inquiries:

Toronto

Email:

Toronto

Email:

WeirFoulds^{LLP}

www.weirfoulds.com

Toronto Office

4100 – 66 Wellington Street West
PO Box 35, TD Bank Tower
Toronto, ON M5K 1B7

Tel: 416.365.1110
Fax: 416.365.1876

Oakville Office

1320 Cornwall Rd., Suite 201
Oakville, ON L6J 7W5

Tel: 416.365.1110
Fax: 905.829.2035