Ukraine war and issue of 'deemed' FM

STUART JORDAN* takes a closer look at the implications of the Russia-Ukraine war on the construction industry, in terms of contracts, material supply and secondary effects.

IT is a little over two months since Russia invaded Ukraine and yet the effects of it on our industry, in the Gulf and globally, are already being felt. I should acknowledge at the start that none of this bears comparison with the human tragedy in Ukraine; which is another matter entirely.

The war joins a list of events in the past few years which have disrupted progress in planning and procurement, and will inevitably disrupt progress in the execution of works. Even so, I am still always surprised at the speed at which events like this take effect on projects and the speed at which they start to be reflected in construction contract terms.

Of course, war is an obvious Force Majeure (FM) event and the Russia-Ukraine war may, therefore, become the basis of FM claims in existing projects, where contracts were signed before the invasion. This is subject to it meeting the other criteria of Force Majeure, one of which is usually that the event could not reasonably have been foreseen. There could be some interesting discussions in relation to the build-up of forces on the Russia-Ukraine border for several months before the invasion.

In relation to contract negotiations right now, the war of course cannot be considered unforeseeable, but contractors and suppliers have begun sometimes to request that it is treated as a "deemed" Force Majeure event. This is because the event is so big and so new that there is no realistic way to predict its eventual impact on supply chains. The merit in this "deemed FM" approach is in avoiding contractors and suppliers having to guess at that impact and adjust their proposed schedules accordingly. If forced to commit to a new schedule they are naturally going to err on the safe side and adjust for long delays, which project owners want to avoid.

In terms of cost, the thinking (as far as I have seen) is similar: paying parties need to accommodate unavoidable increases but they want to delimit that exposure as tightly as possible rather than pay for increases that eventually do not materialise.

So the most immediate potential tool under discussion (in my experience) is price fluctuation provisions. This is the allowance of contract price change (up or down, but usually up) when specified inputs (usually materials prices) deviate from agreed benchmark prices in published market indices, such as the London Metals Exchange (LME). Price fluctuation provisions were common until around 20 years ago and were included in some published forms of contract, but they tended to be ignored and deleted. Maybe they are back, for now.

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Specifically, the war appears to have had an immediate effect in relation to certain metals and other critical materials. Nickel trading on the LME was suspended briefly in March, the price having quadrupled in one morning. Even steel is affected because production in Europe reportedly depends in large part on cheap Russian coal.

Price fluctuation provisions of course are a result of uncertainty in pricing rather than of price inflation per se – and this is going to affect bigger projects, with global sourcing and longer lead times, disproportionately.

There has also been increased discussion of "price lock in" agreements to protect owners from future cost increases. These agreements can be useful in setting the rules for the tender process and stating a period for which prices will be held firm, but we should acknowledge the obvious limitation: if the full construction contract terms, schedule and works scope are not in place, it is difficult to enforce a commitment just to hold prices. Contractors might submit a bid with the held prices but not agree other essential terms. The only true "price lock" for a project is a fixed price contract to deliver it – and even then, there are always some price adjustment events included.

In this regard, we note that the war is being treated differently to the treatment of Covid-19 in construction contracts. Again, just from my experience and in anecdotal evidence from others, Covid has generally not been recognised as a Force Majeure event but new laws (that is, laws imposed after the contract is signed up) are often recognised as Force Majeure. This might apply to new laws globally or just in-country.

Again, as a generalisation, Covid (or new Covid law) has not been treated as a cost issue: although, of course, the pandemic is capable of causing supply shortages (and thereby price increases), there has generally been no allowance for the additional cost arising from these supply chain disruptions.

Finally, we see an increased focus on secondary effects of the war. In particular, contracting parties and bond providers are vigilant about avoiding assignment to sanctioned entities – or about being required to act in contravention of sanctions, which can take us into new ways of thinking about Applicable Law provisions. ■

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