

‘Deal or No Deal?’

Issues arising for the
UK construction industry
from Brexit

Supporting Real Construction
and Building Contractors

CONTENTS

<u>Deal or No Deal?: Introduction</u>	2
<u>Supply Chains</u>	5
<u>Labour</u>	9
<u>Contracts</u>	12
<u>Conclusion on Brexit uncertainty</u>	25
<u>Our Experts</u>	26

‘DEAL OR NO DEAL?’: Issues arising for the UK construction industry from Brexit

Introduction

With the transition period expiring on 31 December 2020, the prospect of leaving the European Union without a deal is a very real possibility. After nearly 50 years of developing rules and regulations with our European counterparts which affect almost every aspect of our daily lives, the UK may be about to start afresh. Add a global pandemic to the challenges of Brexit and the result, as viewed by Irwin Mitchell LLP and the National Federation of Builders, is that it may well be one of the most testing periods in modern memory. With negotiations for a deal still ongoing, it is impossible to predict what the terms of any ‘Deal’ would be and what this would mean specifically for the UK construction industry.

However, logic would dictate that any ‘Deal’ is likely to produce a trading environment for the UK where conditions of trade with the European Union and its Member States will be more restrictive and onerous than those which exist currently. To the extent this proves to be the case, the potential difficulties raised in this Paper in relation to a ‘No Deal’ Brexit may apply to an equal or lesser extent to any Brexit deal.

In the UK, the construction industry is perhaps one of the industry’s most vulnerable to significant change owing to the “extraordinary diversity of professionals, specialists and suppliers” which work within it.¹ Whilst each professional, specialist and supplier has its own role on any construction project, they are all inter-reliant on one another to secure project delivery to the required quality, on time and on budget. The industry as a whole operates a delicate balance of managing risk and reward through careful project management and the exercise of intelligent commercial thinking. The impact of these attendant risks is illustrated by the fact that the industry accounts for approximately 6% of UK GDP but a disproportionate 20%² share of the UK’s insolvencies. It follows that any change to the construction industry’s operational status quo as result of a ‘Deal’ or ‘No Deal’ Brexit could have a significant and potentially detrimental impact on the industry and those operating within it.

¹ Construction Contracts, Law and Management, 5th Edn. p.1.

² The figure for Q2 2020 was 18% per the Insolvency Service’s Quarterly Company Insolvency Statistics. Total insolvencies were significantly down compared with the same period in 2019. Some believe this portends a sharp rise in the near future to ‘catch-up’.

For the construction industry, analysts believe that May 2020 was the low point, where the industry shut-down, sites fully closed and personnel withdrew from work resulting in a shrinkage in construction output by some 35%.³ The industry is now seeing signs of recovery with 28% more projects starting in August 2020 than in May 2020 and “the value of projects starting on site averaging £4,700 million per month during the three months to August”.⁴ The trajectory of the industry’s recovery is also encouraging, with best forecasts suggesting that the value of project starts could return to near pre-pandemic levels by 2022.⁵

For the purposes of this Paper, the primary focus is on the issues and considerations for contractors arising from a ‘No-Deal’ Brexit. Over the coming weeks, we will find out whether or not the UK’s January 2020 departure from the EU will be followed by a ‘Deal’ with the EU. It is thought in some quarters that a ‘Deal’ would result in the least disruption the construction industry and would avoid the negative consequences of a ‘No Deal’ Brexit. Whilst this may be true, the actual impact of any deal (as compared to a ‘No Deal’) will not be known or realised until the terms of any ‘Deal’ are finalised and understood. The 2.2 million people⁶ who work in the UK’s £106 billion construction industry⁷ must turn their attention to understanding the potential impacts of a possible ‘No Deal’ Brexit⁸ and how these potential impacts may even apply (to a similar or lesser extent) even in the event of a deal.

The analysis and comment in this Paper covers three areas⁹ which may be impacted as a result of a ‘No Deal’ Brexit, namely:

- Supply Chains;
- Labour; and
- Contracts.

³ Glenigan Construction Review Paper for August 2020 – Produced September 2020. p.7.

⁴ Ibid.

⁵ Glenigan UK Construction Forecast 2020-2022. P.8

⁶ Employment by industry – Office for National Statistics Dataset - 11 August 2020.

⁷ Construction Contracts, Law and Management, 5th Edn. p.1 – The term ‘Construction Industry’ shall be used in its broadest sense.

⁸ Government Construction Strategy 2016-2020, p 3.

⁹ <https://www.theconstructionindex.co.uk/news/view/the-big-three-brexit-issues-still-facing-uk-construction>

The current situation

Since the UK formally left the European Union at 11:00 on 31 January 2020, our relationship with the European Union has been governed by the Withdrawal Agreement. The Agreement essentially allows the UK to continue on the same terms as it had with the EU prior its formal departure, and allow the UK time to negotiate a new 'deal' until 31 December 2020. The UK, will of course, leave the single market and customs union whether a deal is achieved or not, but if the UK and EU fail to negotiate a deal by that date, the UK Government's position is that it will leave with 'no deal'. That means the UK would initially adopt the terms of the World Trade Organisation ("WTO") (an organisation which governs trade between states) and would be treated as a third country. For the construction industry, the WTO terms will influence:

- the cost of goods imported to the UK including raw materials for building works;
- the free movement of workers from EU states who form part of the 2.1 million people working in the UK construction industry (although this is not contingent only on a 'No Deal' Brexit); and
- the contracts used across the UK construction industry.

In most cases the performance of each construction activity undertaken is measured by reference to three criteria: time, cost and quality. These performance criteria are interdependent on one another and if one is impacted, it is likely one or both of the others will be too. Leaving the EU will likely impact these aspects but leaving with no deal may exacerbate the issues further. These themes are used to analyse the impact and practical effect on contractors in the construction industry across Supply Chains, Labour and Contracts.

It should be borne in mind that the negotiations between the UK and the EU are fluid and ongoing. This Paper is therefore intended to read as an indicative guide to what could happen in the event of a 'No Deal' Brexit, rather than to be relied upon as formal advice. The various aspects referenced in relation to a 'No Deal' Brexit in this Paper could (to an equal or lesser degree) apply also if a deal is agreed. However, this will depend on the negotiated terms of any deal which this Paper cannot usefully speculate upon.

SUPPLY CHAINS

What could be the impact of 'No Deal' on supply chains - materials and building supplies?

The UK construction industry is heavily reliant on imported materials for its building activities, with the EU being the source of 51% of all UK imports in 2019, representing a value of £372 billion.¹⁰ Until 31 December 2020, the materials imported by the UK receive the benefit of the EU's Single Market and Customs Union. The Single Market allows goods including materials to move between EU countries freely and without charges, taxes, quotas and tariffs. The Customs Union means that when goods arrive from other EU countries, they are subject to zero tariffs. It is therefore easy to see how a small increase in the tariffs could represent a huge cost to the construction industry if current import levels remain the same.

For contractors, having an awareness of the likely effect of tariffs being imposed on goods and materials which they import to complete any works is essential. As will be covered in greater detail in the building contract analysis below, the contractor typically bears the burden of any increase in materials cost under, for example, standard JCT building contracts. More fundamentally, knowing the price of materials is fundamental to the contractor's ability to tender for projects with the requisite levels of certainty in order to be competitive. The prospect of at this stage unknown charges, taxes, quotas and tariffs represents a direct challenge to the ability of UK contractors to be competitive.

Cost

If we leave the EU without a deal, it is generally understood that imports on goods for use in the construction industry will be subject to additional costs.¹¹ The UK would trade with the EU on WTO terms which would impose average tariffs on imported UK non-agricultural goods of 2.8%.¹² It is plausible that the import of raw construction materials could face higher tariffs. The value of UK exports to the EU in 2019 was £300 billion,

¹⁰ House of Commons Briefing Paper Number 7851, 17 June 2020. [https://commonslibrary.parliament.uk/research-briefings/cbp-7851/#:~:text=The%20EU%2C%20taken%20as%20a,%25%20of%20all%20UK%20imports\).](https://commonslibrary.parliament.uk/research-briefings/cbp-7851/#:~:text=The%20EU%2C%20taken%20as%20a,%25%20of%20all%20UK%20imports).)

¹¹ <https://www.rics.org/uk/news-insight/latest-news/news-opinion/building-tender-prices-forecast/>

¹² <https://www.bbc.co.uk/news/uk-45112872#:~:text=Under%20WTO%20rules%2C%20after%20Brexit%2C%20cars%20would%20be,average%20of%20more%20than%2035%25%20for%20dairy%20products.>

presenting 43% of the UK's exports.¹³ The EU also exports to the UK and any tariff it imposes on the UK may simply be imposed by the UK as well on any imported goods from the EU. However, when trading under WTO terms the rules require a member to trade with all other members on the same terms unless a trade agreement is in place.

From 1 January 2021 a new UK Global Tariff ("UKGT") will apply on all goods imported. This change is not necessarily for the worse. In fact, when we inputted six of the key building materials identified by the Department for Business, Energy and Industrial Strategy (BEIS) in their latest monthly statistics report¹⁴ into the UKGT tariff calculator, all six materials reported no change in the tariff applicable, of which all six were a 0% tariff. Whilst this is not to be taken as conclusive (inevitably there will be some goods subject to increased tariffs), it is encouraging that the transition to a new tariff system will not necessarily have a wholly negative impact. It would be overly simplistic to conclude that simply because tariffs have not changed in some limited circumstances that the treatment of the goods themselves has not either. For contractors importing Timber from 1 January 2021, they will have "to show imports from the EU and European Economic Area (EEA) have been legally harvested",¹⁵ for example. This exercise of checking the source of product origin does not apply to all imported goods, however, contractors should factor in additional time to complete these checks.

The construction industry is characterised by large turnover and small profit margins across all sizes of projects. In 2017, analysis showed that the average margin across the largest 100 construction companies in the UK was just 1.5%.¹⁶ This leaves little room for inflation or rising costs in raw materials needed for projects, or the accommodation of any new or revised tariffs. It is recommended that contractors check the key materials they import from outside the UK to ensure they know of any changes to tariffs which impact them and consider the likely impact on their end costs. Planning and accounting for revised costs could help contractors when determining the commercial viability of some existing projects and for future project on which they are yet to be engaged.

¹³ [https://commonslibrary.parliament.uk/research-](https://commonslibrary.parliament.uk/research-briefings/cbp7851/#:~:text=The%20EU%2C%20taken%20as%20a,%25%20of%20all%20UK%20imports)

[briefings/cbp7851/#:~:text=The%20EU%2C%20taken%20as%20a,%25%20of%20all%20UK%20imports](https://commonslibrary.parliament.uk/research-briefings/cbp7851/#:~:text=The%20EU%2C%20taken%20as%20a,%25%20of%20all%20UK%20imports))

¹⁴ Aggregates, cements and concrete, clay, timber, metal, plastic. Department for Business, Energy and Industrial Strategy Monthly Statistics of Building Materials and Components August 2020 No. 546

¹⁵ Trading timber: imports and exports from 1 January 2021 <https://www.gov.uk/guidance/trading-timber-imports-and-exports-if-theres-no-brexiteal>

¹⁶ <https://www.theconstructionindex.co.uk/news/view/trouble-at-the-top-2017-top-100>.

Time

It is likely that the import of goods and materials from the EU will take longer than under the current free trade regime. That is because of the expected increase in border checks for goods entering the UK as the nature, value and origin of the product will have to be identified, along with applicable duties. This is likely to be exacerbated by the disruption to the supply chain resulting from the coronavirus pandemic.

The increase in the import time of goods from the EU will impact the 'just-in-time' procurement process which dominates the UK industry, including construction. Research by the British Chamber of Commerce suggests that 36% of traders in the UK rely on just-in-time imports for the "immediate delivery of material or components as they are required".¹⁷

For contractors, the increase in time is likely to impact the rate of progression on projects and delay any stage payment system which may be in place. In turn, this directly impacts contractor cash flow and turnover, further squeezing the fine margins on projects.¹⁸ It will be essential for contractors to be aware of their existing contractual obligations, particularly in respect of any provisions relating to time and performance. At a financial level, understanding how your projected cash flow will be impacted as a result of the increase in time will help to reduce your exposure to unexpected changes.

It is also advisable to contact and speak with the 'key players' in your supply chain to understand how they anticipate handling the changes to the increase in time for the delivery of goods. Good communication is crucial at this stage, while there is still time may allow contractors to implement or revise their processes for procuring the goods and materials they require for their construction projects.

Quality

The current quality of construction machinery, materials and products entering and leaving the UK is controlled by EU regulations. There are concerns raised by experts in the industry that these standards could change. The government guidance suggests that from 1 January 2021 the existing standards of quality in force will become UK 'designated standards' meaning the standards will remain the same. The main changes relate to the placement of construction goods on the UK market and therefore, should not apply as widely to contractors. It is recommended that contractors monitor the developments regarding the quality of construction materials in the UK to ensure they can comply with any late change in quality standards. The

¹⁷ <https://www.britishchambers.org.uk/media/get/Infrastructure%20Survey%20Fact%20Sheet.pdf>.

¹⁸ Glenigan UK Construction Forecast 2020-2022. p.8

UK government has stated that it will recognise CE marked products in the UK market until January 2022, which should relieve some uncertainty for Contractors at least in the short-term. Contractors and designers should monitor the position carefully and be cautious when entering into contractual obligations in respect of quality and standards.

Recommendations

Our recommendations for contractors are as follows:

- Factor in margins to assist with pricing jobs to take account of possible raw materials cost increases as well as any applicable tariff increases. In a market where competitive tendering is the norm, there is, however, a risk of distortion of competition as some bidders factor these matters in and others do not;
- Check with your supply chains to ensure you know the origin of products and materials which you import for your construction projects;
- Speak with the key players in your supply chain to establish how they intend to accommodate any changes from 1 January 2021; and 1 January 2022 (when CE marking will no longer be applicable in the UK market);
- Take into account additional time for receiving goods which you import into the UK to account for new checks and customs controls;
- Plan and factor in how the possible changes could impact your cash-flow; and
- Find out who your points of contact are in your supply chain should disputes arise.

LABOUR

Immigration & Employment Rights

EU citizens who are living or working in the UK prior to 1 January 2021 can remain here until 30 June 2021 if they have applied to remain in the UK under the EU Settlement Scheme. They will either be given settled status or pre-settled status. The status they get depends on how long they have lived in the UK when they apply. Their rights will be different depending on the status they receive but in both cases they will be able to work in the UK.

EU citizens will usually get settled status if they started living in the UK by 31 December 2020 and lived in the UK for a continuous five year period (known as 'continuous residence').

EU citizens that do not have five years' continuous residence on the date they apply will usually get pre-settled status (which is, essentially, a five year visa). They will only be able to apply if they started living in the UK by 31 December 2020. They can change this to settled status once they have five years' continuous residence provided they apply before their pre-settled status expires.

Unless the UK and the EU agree a reciprocal agreement about free movement (which is very unlikely), the right of EU citizens to live and work in the UK will end at 11pm on 31 December 2020. After that time, anyone wishing to come to the UK to work (including all EU citizens not already in the UK) will have to comply with the new immigration 'points based' system. This will make it much more difficult and expensive for the construction sector to recruit anyone from outside the UK.

The new immigration system is designed to attract 'skilled workers' who are defined as people who can speak English and have (at least) 'A' level or equivalent qualifications. In addition, they must have a job offer from a licenced sponsor and earn at least £25,600 per year (or the going rate if it's higher than that). Points are given for each characteristic and an individual has to have a minimum number to qualify. Points are available for any roles that are set out in the 'shortage occupation list' which is updated from time to time to. The current list includes engineers, architects and quantity surveyors, but not plumbers, electricians and bricklayers etc. These requirements will exclude many construction workers and there isn't a temporary work route available.

Even if businesses can meet these requirements, the costs involved in getting approval to bring someone into the UK to work will be enough to put most businesses off. Employers who sponsor workers under the points based system must pay £1,000 per skilled worker for the first 12 months, with an additional £500 charge for each subsequent six month period.

Construction businesses will, therefore, have to look for home grown talent to fill vacancies. One option is to encourage young people to access training and employment routes into the construction sector in both the short and long term. The Apprenticeship Levy Scheme was introduced in 2017 and requires businesses with a payroll of over £3 million to pay 0.5% of their payroll costs to HMRC to fund the levy. It effectively shifted the cost of funding apprenticeships from the government to large employers. The scheme is open those businesses that fund the levy and those that don't.

The government has also introduced incentive payments for employers who hire a new apprentice of £2,000 for apprentices aged between 16 and 24 and £1,500 for those aged 25 and over. These payments are in addition to the £1,000 employers already receive for hiring an apprentice. There are a few rules that apply: the apprentice must be a new employee to the business, be employed under a contract of employment (and begins working between 1 August 2020 and 31 January 2021) and have not previously worked for the same employer in the previous six months. Training new people will take time and if there is a labour shortage, wage costs will inevitably go up.

With almost 40% of respondents in the recent MHA Construction Sector Report looking to hire in the next year, and a further 15% unsure, now is the definitely the right time for the UK to address working in construction and real estate in this country and making it a more attractive career for UK jobseekers.¹⁹

Employment Laws

A significant proportion of UK employment laws are derived from the EU. These include the rules which restrict working hours, provide minimum rest periods and holiday pay and those that protect employees if the business in which they are employed changes hands. The legislation which imposes minimum rates of pay is a purely domestic law.

If we do not agree a deal, the UK will not be bound by decisions of the Court of Justice of the European Union and the government will, potentially, be able to make radical changes to employment laws. However,

¹⁹ MHA Construction Sector Report. Autumn 2020, pg 18.

we do not expect the government to make any immediate changes to employment laws. The former Prime Minister Theresa May, promised to protect workers' rights and Boris Johnson has said that he will introduce an Employment Bill which will introduce a right for all workers to request a more predictable contract and make flexible working the default unless employers have a good reason to depart from it.

In addition, once the UK's withdrawal from the EU becomes effective (and subject to any agreement between the UK and EU on their future relationship) the UK will not have to transpose any new EU law into domestic law.

Recommendations

If they not done so already, Contractors and others in the construction industry should encourage their EU staff to apply to remain in the UK (it's free to apply) and explain to them what will happen if they lose the right to live and work here. The Home Office has an easily accessible employer toolkit to help explain the process.

CONTRACTS

The potential implications of Brexit uncertainty are set out in detail above but the events those implications may lead to can be summarised as follows:

- **The imposition of, or a change to, duties, tariffs or taxes imposed on imports:** as explained above, goods and materials which Contractors ordinarily sourced from or through the EU, may be subject to an increase in costs following a no-deal Brexit due to the imposition of duties, tariffs and taxes. These increased costs of goods and materials will add to the cost of completing a project and the contractor would want to seek a proportionate increase in the price it is able to charge its Employer.
- **Labour and skills supply shortages:** following a no-deal Brexit, the right of EU (as opposed to UK) workers to work in the UK will be compromised and contractors may not be able to rely on the EU as a source of labour and skills supply. Contractors will have to rely on and recruit from a smaller UK labour market and may have to suffer deployment and skills shortages during the replacement recruitment process. This could compromise a contractor's ability to stick to programme and deliver the project on time, to say nothing of the added costs and expense a contractor would incur in recruiting an all-UK workforce.
- **Delays at the border & transport issues:** a no-deal Brexit would inevitably undo the free movement of goods and people which the UK economy currently enjoys with the EU. This may lead to delays in the transport of construction goods and materials due to the need for hard border checks. Contractors would not be able to guarantee delivery of the project on time and so they would be exposed the delay liabilities and loss and expense unless the contract provided some relief to them for such matters.
- **Increased costs of compliance/certification:** the UK Government plans to create the UKCA mark to replace the CE mark, and has recently stated that it will allow CE marked products to be placed on the UK market until 1 January 2022 (whereupon the UKCA will apply). Therefore, even in the event of a no-deal Brexit, there would at least in the short-term be a period of agreed mutual recognition of both standards, and mean that UK businesses (including Contractors) will not in this period have to repeatedly test products for and from different markets. There had been much fear that without this measure, there could be substantial costs and delay to projects involving or specifying products to

be used and delivered. Again, this would have exposed Contractors to delay, increased overheads and a general lack of competitiveness when it comes to procurement of projects. However, as referred to above, this is a temporary measure and the industry will no doubt be keen to ensure that the new UKCA closely aligns with the CE, especially if UK contractors will continue to operate in markets where the CE standard will still be the yardstick; UK contractors will want to have certainty that a material meeting a UKCA standard will also pass its equivalent CE standard without undue delay, testing or dispute. The greater the harmonisation, the greater the peace of mind.

The main mechanism by which the consequences of these events will be felt by Contractors is through the terms of the contracts the contractors are performing (or they are due to perform).

Contractors will need to:

- i. consider the existing terms of their current contracts so the potential contractual consequences of a no-deal Brexit can be understood and (if possible) mitigated; and
- ii. critically examine and (if possible) seek to negotiate the proposed terms, programmes and/or specifications and the like of future contracts in order to de-risk them.

Existing Contracts

Unless a contractor consistently enjoyed an unusually strong bargaining strength, the contractor is unlikely to have negotiated terms in all its existing contracts which would provide it with relief if any of the no-deal Brexit events (as detailed above) was to occur.

The usual position in most standard form contracts (JCT and NEC) is that the contractor ordinarily takes the time and cost risk of both the supply of goods and materials and the availability of labour. Contractors could be forgiven for thinking that a no-deal Brexit would be an event under most standard form contracts that would provide relief to a Contractor in terms of obtaining an extension of time or recovering loss and expense. However, as detailed below, that is probably not the case, but the wording of any clauses or amendments to the standard form contract clauses in these areas should always be checked.

JCT: 'Relevant Events' for obtaining Extensions of Time

Taking the JCT Design and Build 2016 form as an example, many Contractors will be familiar with the range of 'Relevant Events' set out at clause 2.26 the occurrence of which may entitle the contractor to an extension of time. The table below considers the Relevant Events that might be thought to be applicable to matters arising from a no-deal Brexit.

Potentially 'Relevant Event'	No Deal Brexit Analysis
Clause 2.26.1: "Changes and any other matters or instructions which ... are to be treated as, or as requiring, a Change". A Change expressly includes "... after the Base Date a change in the Statutory Requirements which necessitates an alteration or modification to the Works..." (Clause 2.15.2.1)	To the extent this could be shown to apply, it would not provide the Contractor with an extension of time to the extent delay related, for example, to delays caused at the ports of entry or labour or material shortages.
Clause 2.26.12: "the exercise after the Base Date by the United Kingdom Government or any Local or Public Authority of any statutory power that is not occasioned by a default of the Contractor or any of the Contractor's Persons but which directly affects the execution of the Works"	In the case of a negotiated withdrawal agreement (where a deal <u>is</u> agreed), primary legislation would be passed and so the contractor would, in principle, be entitled to an extension of time. However, a no-deal Brexit may not involve the UK passing any legislation and so it is not clear that any statutory power would be exercised in order for the Relevant Event to apply.
Clause 2.26.13: "delay in receipt of any necessary permission or approval of any statutory body which the contractor has taken all reasonable steps to avoid"	To the extent this could be shown to apply (which is doubtful), it would not provide the Contractor with an extension of time to the extent delay related, for example, to labour or material shortages.
Clause 2.26.14: "force majeure"	As detailed below, the common law definition of this Relevant Event generally requires event to make it impossible the contract to be impossible to perform on time (not merely to be more expensive or difficult). It is also thought that the event must be one which could not have been foreseen at the date the contract was made. A no-deal Brexit has been recognised as a possibility for a considerable time. As a result the added costs and delay of no deal tariffs, taxes, duties, certification, testing, border checks and port delays would probably not amount to a force majeure.

As such, the contract will have to provide explicit bespoke drafting in the form of an amendment which deals squarely with no-deal Brexit in order to have a clear route to an extension of time.

JCT: 'Relevant Matters' for recovering Loss of Expense

It is a similar picture for the 'Relevant Matters' that entitle the contractor to recover loss and expense under clause 4.21 of the JCT Design and Build 2016. The majority of the 'Relevant Matters' allowing for loss and expense arise out of a default by the Employer or interruptions to progress on site due to the Employer or Employer's Persons.

Whilst a change in 'Statutory Requirements' may constitute a Change which could constitute a 'Relevant Matter' (clause 4.21.1), this would not cover the Contractor's loss and expense where it has had to pay a higher price for materials due to price increases/tariffs and/or higher staffing costs.

Once again, this emphasises the need for bespoke no-deal Brexit amendments

NEC: 'Compensation Events' for Time and Cost

The position is very similar under the NEC forms of contract where 'Compensation Events' (under to clause 60) can entitle the Contractor an extension of time and recovery of any loss and expense.

Most of these 'Compensation Events' arise primarily from a default by the Employer or other contractors. However, the most likely 'Compensation Events' to potentially apply in the NEC form are:

- i. **Clause 60.1(19):** provides a 'Compensation Event' which "...stops the Contractor completing the works by the date shown on the Accepted Programme, and which neither Party could prevent (and which) an experienced contractor would have judged at the Contract Date to have such a small chance of occurring that it would have been unreasonable for him to have allowed for it". This is potentially applicable to a no-deal Brexit but it will be contentious as to when the chance of a no-deal Brexit was such that it was not unreasonable to allow for it.
- ii. **Secondary option clause X2.1 (if it applies):** deals with a change in the law of the country in which the Site is located if it occurs after the Contract Date. The drafting of this optional clause (which could lead to price decreases as well as increases) is likely to cover Brexit related delays for sites in the UK in the case of a deal between the UK and the EU (where there has been a change in law). However, a no-deal Brexit may not involve any change in law and so this may not assist the Contractor.

Given the lack of certainty, the NEC form does not deal squarely with Brexit (or a no-deal Brexit) without bespoke drafting in the form of amendments.

Other Considerations for Existing Contracts

Contractors should carry out an audit of existing contracts that have a connection to and/or reliance on UK/EU trade. They should seek to identify and understand the possible effects that Brexit-related events which were unanticipated when the contract was entered into may have on existing contractual rights, obligations and remedies, including any consequential impact on timing, performance and enforcement. Performance of a contract may become inherently more difficult and, consequently, more time may be required for performance, driving up costs. Previously serviceable contracts could become commercially unattractive or even unprofitable. A party may face claims for breach of contract or termination for default.

As a minimum, Contractors should consider the following:

- **Timing:** What is the commitment to timing and delivery?
- **If delivery is 'late'**, what are the consequences under the contract?
- **Termination:** Is there a right to terminate the contract (or engagement under it) where the materials are not supplied by the date of delivery or within a specified delivery window? The Contractor may also be exposed to a claim for damages for losses incurred caused by the failure to deliver the materials on time. This may include the costs of procuring and sourcing replacement materials.
- **Damages:** If the Contractor is exposed to a claim for damages (liquidated or general), consider the extent of any potential exposure. Does the contract include a provision limiting or excluding liability in certain circumstances?
- **Mitigation:** If the form of contract permits it, the parties should work together to identify and seek to mitigate any losses which may arise or have arisen to minimise exposure. For example, it may be sensible (if not already a contractual obligation) for the Contractor to notify the other party of any potential delay as soon as (or before) it becomes likely. It may also be sensible to agree the advance ordering and storage of materials that might become more difficult to procure or for which lead times might become protracted.

Future Contracts

The ability of contractors to secure amendments to prospective contracts in relation to a possible no-deal Brexit will inevitably be tied to the relative strength of their negotiating position in relation to the employer and/or the project. The aspects discussed below cannot therefore be regarded as 'must-haves' but should inform all contractors what aspects should be thought about.

For example, an employer refuses a bespoke amendment to allow the contractor an extension of time if a no-deal Brexit leads to extra port and border checks which causes delay in goods and materials being delivered to site; the contractor should pre-emptively seek to extend the period for completion and make other adjustments to the programme so that it avoids delay liability to the employer. Similarly, if an employer does not agree a term allowing for the contractor to be reimbursed for no-deal Brexit tariffs and duties, the contractor should consider adding caveats to its tendered contract price to allow for recovery of these possible costs.

So long as contractors are pro-active about the risks posed by a no-deal Brexit in contract negotiations, employers in the market may have to acknowledge that a more collaborative approach to these risks will be required. The market may not tolerate the whole risk being passed down the supply chain so that it is borne by the smallest and least able to bear it.

Under the sub-headings below, we discuss the factors which should be raised by contractors and considered by the parties generally when negotiating future contracts.

Brexit / No Deal Brexit Events

Parties should seek to identify, allocate and (where appropriate) share the risk of uncertain Brexit-related adverse consequences (including those associated with a no-deal Brexit). In the current climate of uncertainty, it is unrealistic to attempt to cover every potential eventuality. However, the parties may consider the inclusion of an express 'Brexit clause' or 'No Deal Brexit clause' which would seek to define the event(s), the occurrence of which would trigger a review process and/or certain changes in the parties' respective contractual rights, obligations and remedies.

Any provision must be clear as to what constitutes such an event and how/when it might be triggered. The parties should consider:

- to what extent would the Brexit-related event need to cause the adverse consequence in order to trigger the provision and how narrowly that adverse consequence should be drafted?
- the inclusion of a time period following the triggering event in which a Brexit provision must be invoked by the party claiming relief (failing which, the right to rely on such an event is lost).
- a restriction preventing a party from seeking to rely on the same triggering event to excuse its repeated breaches or delays.

Caution needs to be taken by the contractor in the negotiation and drafting of 'Brexit clauses', which are likely to come in two broad forms:

- 'Specific event' clauses can be used in a contract (for example, in the event that currency exchange or interest rates fluctuate, or certain restrictions on importing have been introduced) which would then result in a specific consequence for either party (for example, as a result of the specific event, the price will decrease or a party will have the ability to use a different contractor). The risk with these types of specific clauses is that other events may occur which may be beyond the scope of the wording in the clause, rendering the clause subject to challenge (and even meaningless) in relation to such an event.
- 'Trigger events' can also be used in contracts (for example, the imposition of tariffs, a change in regulatory requirement, one of the party's costs increasing, etc.) Depending on how the clauses have been drafted, these types of trigger events could mean that the affected party may request that the contract is renegotiated. If no deal can be reached, then the contract could also be terminated. The risk with these types of trigger events is that the party that is not affected by the specific Brexit event faces the choice of either accepting the less-favourable terms or early termination. The broader the trigger event is drafted, the easier it will be for the affected party to argue that such a trigger event has taken place. In contrast, where a trigger event is narrowly drafted, the affected party may struggle to argue that such an event captures what has actually happened.

Pricing Clauses

The parties will need to consider whether it is clear, after a no-deal Brexit, who will be responsible for any additional costs payable under the contract or incurred in its performance (such as tariffs, import duties,

taxes or general increases in procurement costs). Both parties will want to ensure that the prices remain favourable to them throughout the duration of the contract. In particular, the contractor will want to include provisions enabling it to pass on any additional charges to the employer, while the employer is likely to resist any such provisions. This will inevitably be a negotiation exercise but the parties may wish to consider a range of prices or a bespoke fluctuation provision for aspects related to no-deal Brexit taxes, tariffs and duties.

Currency Fluctuations

Fluctuations in exchange rates (which are predicted to become volatile) may have a significant impact on the sums due under the contract if such sums are being paid in a different currency. The parties may wish to include a “Currency” clause to protect the parties against material currency fluctuations which may cause performance under the contract to become uneconomic.

The currency clause could provide that where the contractor’s costs of providing the goods and materials fluctuates by more or less than a certain percentage compared to a benchmark that is pre-agreed or calculable by reference to a pre-agreed mechanism:

- (preferably) the parties will amend the price of the costs payable under the contract to appropriately address the change in the currency; or
- the parties will discuss, in good faith (i.e. honestly, fairly and consistently with the justified expectations of the other party), the proportion of the sum that shall be invoiced, as is fair and equitable in the circumstances.

Warning Notices

Where either party is concerned that the costs incurred and payable under or in the performance of the contract may change, it should notify the other party as soon as possible to enable the parties to negotiate any necessary amendments to the contract.

Going forward, consideration should be given to inserting provisions in future contracts to oblige both parties to use early warning notices to notify the other party if it anticipates that a specific event (defined within the contract) may occur.

Separately, parties may want to include “Financial Distress” clauses. These oblige a party to inform the other party if a specified event occurs. These events will link directly to the party’s financial position and may include profit warnings or public statements about material deterioration or breaching bank covenants. Where such an event occurs, the Financial Distress clause would require the relevant party to provide a notice to the other party within a certain period of time. The parties would also ideally be subject to any confidentiality provisions included within the contract where such clauses are to apply.

Force Majeure & Frustration

If the parties are unable to agree to a variation to the contract and the contract becomes impossible to perform without such a variation, the Contractor may need to look to what is known as a ‘force majeure’ clause. This clause excuses a party from performing its obligations under a contract if it is prevented from doing so by an event that is beyond its reasonable control.

Brexit may trigger a force majeure clause (depending on the terms of the contract) but as with many things Brexit-related, the position may not be clear. However, it is unlikely (without a specific amendment to usual force majeure clauses) that the common law meaning of force majeure will provide the Contractor relief given that the event in question is arguably foreseeable. The issue is that Brexit (even a no-deal Brexit) is unlikely to make performance of the work impossible. Instead, performing the contract may become more difficult or more expensive.

The party seeking to rely on a force majeure clause would need to prove that there is no alternative way to perform its obligations. For example, if the supplier finds that performing the contract becomes more costly due to changes in import tariffs, the supplier would still be able to provide the goods, it would just be more expensive (and potentially unprofitable) to do so. In this case, the supplier may not be able to rely on the force majeure provision to assist.

Whether a Brexit related event falls within the scope of a force majeure clause will depend on the terms of the contract, and the exact wording of the clause. It will be in both parties’ interest to find a commercial and practical solution to adjustments and work-arounds, and so seeking to rely on a force majeure clause should be considered as a last resort – and only after discussions and negotiations have taken place between the parties.

The use of the term 'force majeure' on its own is unlikely to cover the consequences of Brexit. In the JCT suite, "force majeure" is a Relevant Event entitling the contractor to additional time but not money, although force majeure itself is not a defined term (and therefore now unlikely to cover Brexit-related delays). Some contracts define the expression giving it a specific meaning for that contract. If, for example, the definition did not require the event to be unforeseeable, force majeure maybe a legitimate excuse for non-compliance with a particular contractual obligation. NEC 4 does not use the term 'force majeure' but describes similar circumstances which are a compensation event giving rise to time and money for the contractor. The compensation event has an express requirement of unforeseeability and is therefore unlikely to catch Brexit-related delays.

In either case, given the broad interpretation of "force majeure" at common law, a more robust or specific written definition of the term will be needed in contracts. However, generally speaking, a written definition will narrow the scope of force majeure from the common law position and so is unlikely to be preferred by the contracting party expecting to rely on force majeure to avoid culpability for delay. That said, the NEC ECC Clause 19 (on prevention) is much wider than the common law and so Employers often seek to delete it to revert to the common law meaning.

Consideration of force majeure can be taken a step further to consider 'frustration': where the event in question has such an impact on the whole of the contract so as to render performance impossible. Although it has not yet been tested in the context of Brexit, it is likely that a change in economic or market circumstances, affecting the profitability of a contract or the ease with which the parties' obligation can be performed, will not be regarded as being a force majeure event. The courts are unlikely to accept that a termination on grounds of frustration was lawful if it appears that economic conditions just meant that it is more expensive to perform and less commercially attractive but have not rendered obligations impossible to perform.

Bespoke drafting in this area will be needed if the contractors want the fall back of termination in relation to no-deal Brexit. In any event, it will likely be a contentious point of negotiation.

Specific Standard Form Clauses on Pricing

JCT Contracts - Fluctuations

The JCT suite of contracts has a set of optional fluctuation provisions which are designed to deal with fluctuations (usually upward for the prices of labour and materials). These operate from the base date and

enable price increases to be measured from that base date. If there have been price increases within the parameters agreed by the parties then the contract sum will be adjusted accordingly.

These have not been drafted with a no-deal Brexit in mind but can in principle be used or modified to capture some price increases caused by a no-deal Brexit. The JCT suite allows the parties to agree their own fluctuation provisions and cater for standard forms of fluctuation which can be incorporated through the relevant Contract Particulars. The provisions are routinely deleted.

The JCT Design and Build 2016 sets out fluctuation provisions at clauses 4.2, 4.12, 4.13 and at schedule 7, where 3 types of fluctuation are provided for as follows:

- Option A: contribution, levy and tax fluctuations (included in the back of the JCT contract at Schedule 7). Under this option, the Contract Sum is based on the contributions, levies and taxes that the Contractor is liable to pay as an employer and the duty and tax on goods and materials as detailed in the schedule. Therefore, the price is only varied if these are decreased/increased or a tax is introduced or repealed. There is no allowance for a rise in pay rates or the price of goods and materials.
- Option B: labour and materials cost and tax. Under the option, the Contract Sum is based on the following in respect of workers: (1) the rules and decisions of the Construction Industry Council or other wage fixing body; (2) any incentive scheme and/or productivity agreement under the Working Rule Agreement of the Construction Industry Joint Council or provisions on them contained in the rules or decisions of some other wage-fixing body; and (3) the terms of the Building and Civil Engineering Annual and Public Holidays Agreements; in addition to the contribution, levies and tax fluctuations specified under option A. For materials, the Contract Sum is based on market prices of goods and materials and any duty or tax payable on them. Therefore under this option if prices, wages or taxes increase or decrease by reference to the indices set, then so will the Contract Sum.
- Option C: formula adjustment. Under this option, the Contract Sum is based on a formula issued by the JCT, which divides the work into different categories. Then the works are valued by reference to separate indices for each category set at the Base Month (the month before tender returns), so if they increase or decrease from the Base Month figures so will the contract sum. Some categories of the Contract Sum remain fixed, which could include overhead costs, insurance premiums and the cost of items supplied directly by the Contractor and these are defined in the Contract Particulars by reference to a “Non-Adjustable Element” expressed as a percentage.

NEC Contracts – General

Despite the variety of pricing options available under NEC3, only the rarely used options E (cost-reimbursable) and F (management contract) protect the Contractor against increased underlying costs. Option X1 under NEC3, which has tended to be no more popular than the JCT fluctuations provisions, also allows for indexed increases in material costs.

A key clause in NEC contracts is “the Parties, the Project Manager and the Supervisor act in a spirit of mutual trust and co-operation” (Clause 10.2 in NEC4 ECC), so in the spirit of the contract, parties should be discussing the risk of no-deal Brexit related delays and working to mitigate the likely effects. Brexit-related delays should be logged on the early warning register, early warning meetings held to discuss any issues foreseen and the programme should be kept up to date.

NEC Contracts – Pricing Options

There are also options within the NEC which allow for different pricing options, which could apply to costs increases due to a no-deal Brexit.

In NEC4 ECC there are six pricing options, summarised briefly below:

- Under Options A (Priced contract with Activity Schedule) and B (Priced contract with bill of quantities), there is a lump sum for the works and the supplying party carries the cost risk, save for compensation events allowing for more time or money, or risks allocated under the terms of the contract.
- Options C (Target Contract with Activity Schedule) and D (Target contract with bill of quantities) are contracts where parties agree a target price for the works and respective shares of savings (where the works come in under budget) or overrun (where the target price is exceeded). Under Options A, B, C and D there is the option for parties to incorporate secondary option clause X1 which allows for price adjustment due to inflation.
- With Options E (cost reimbursable contract) and F (management contract) the parties agree levels of overheads and profits and the Client pays the agreed overheads and profits, plus the actual cost of the works, so in effect the Client carries the risk on costs (though under Option F risk allocation can be varied by the options chosen in the sub-contract). Therefore, incorporating secondary option

clause X1 under Options A to D, to cater for inflation or using options C to F, which allow for price fluctuations could provide protection to the supplying party against price increases arising out of Brexit.

There is also nothing to stop the parties to a NEC contract from agreeing and drafting bespoke Z-clauses to deal with the financial and time impacts of a No Deal Brexit.

CONCLUSION ON BREXIT UNCERTAINTY

The uncertainty around a no-deal Brexit has the ability to undermine the growth of many businesses within the construction sector. However, by understanding the issues on supply chains, labour and contracts, UK contractors can seek to mitigate risks wherever possible.

Supply chains will be greatly affected, with the cost, time and quality of materials thought to go up and test the viability of some construction projects. However, there are many actions that Contractors can make, including: factoring in margins to assist with pricing jobs to take account of possible raw materials cost increases as well as any applicable tariff increases; ensuring you know the origin of products and materials which you import for your construction projects and communicating effectively with the key players in your supply chain to establish how they intend to accommodate any changes from.

The impact on labour and resources is also concerning, as with the inevitable increased costs of bringing someone into the UK to work turning construction business to look for home grown talent. This will however take time and is likely to lead to a shortage of skilled construction workers in the immediate aftermath of 30 June 2021. In the intervening time, it is important that Contractors and others in the construction industry encourage their EU staff to apply to remain in the UK and explain to them what will happen if they lose the right to live and work here.

With end of the transition period looming, construction contracts will need to be made as clear as possible, with Contractors taking action now to mitigate against the uncertainty. Contractors should first look to carry out an audit of any existing contracts that have any connection to and/or reliance on UK/EU trade and seek to identify and understand the possible effects on their contracts.

As discussed, Contractors' ability to secure amendments of future contracts will rely on the strength of their negotiating position in relation to the employer and/or the project. Notice must be taken to the relevant areas of concern, including force majeure, warning notices, pricing clauses and currency fluctuations to name a few, however, must also be aware that there are different considerations depending on the type of contract being used.

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