

Brexit-proofed?

Jamie Swan provides a practical guide to safeguarding construction contracts after Brexit



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Since the referendum of June 2016 called for an end to the UK's membership of the EU, questions as to how so-called 'Brexit' will affect the construction sector have been raised and speculation rife. Now that Article 50 has been triggered and the negotiation period has commenced, we are still none the wiser as to what an ex-EU UK will look like. While nothing is certain at this stage we can however start to consider the potential implications that a move away from EU legislation and regulations will have on the construction industry.

Legislation and regulatory changes

We will not of course know what the UK's exit 'deal' with the EU will look like until the government comes to the end of the negotiation procedure. The UK may ultimately maintain a considerable body of EU rules, especially if it hopes to preserve access to the single market.

Speculation in the media is that the outcome will be one of three main archetypes, those being as follows:

- A World Trade Organisation (WTO) model: the UK could utilise its membership in the WTO to govern trade with the EU. By so doing the UK would need to ensure compliance with the WTO's trading regulations, some of which are similar to those obligations currently imposed by the EU on the UK.
- The Switzerland model: following this model would see the UK entering into a series of bilateral

treaties with the EU as well as becoming a member of the European Free Trade Association (EFTA). Bilateral agreements would include provision for the free movement of services and exclude free movement of people. Accordingly, there would still be obligations placed on the UK to comply with EU regulations in certain areas.

- The Norway model: essentially this model involves the UK becoming part of the wider European Economic Area (the EEA) and joining the EFTA. Principles of the EEA that members must accept include free movement of people and compliance with various relevant EU rules, including consumer protection, competition regulations, employment guidelines and environmental principles.

Without knowing which, if any, of the above models the UK will fall into, we can only surmise about potential changes to legislation in the wake of the UK's exit. What we do know is that many of the EU's rules and regulations have been adopted into domestic law. Further, on a wider economic and social level there have been and are likely to be further ramifications for industry, including the construction sector, due to currency oscillations and the possible effect on the number of migrant workers.

Construction law derived from the EU

Little of our construction law actually originates from membership

'Undoubtedly the outlining of potential trigger events for a Brexit clause will require an understanding of the project and real consideration as to the events that would be likely to cause issue.'

of the EU. That does not mean, however, that consideration will not need to be made to certain clauses within construction contracts entered into during and after the negotiation period, which we now find ourselves in subsequent to Article 50 being invoked.

Whether or not laws are repealed, replaced or amended will fall to the government to decide and there will of course be certain laws that will take priority over others; for instance, legislation governing finance and corporations.

Perhaps the most obvious of the construction legislation that does in fact emanate from the UK's membership of the EU is the Construction (Design and Management) Regulations (CDM Regulations). It is rather unlikely however that post-Brexit we will see a revocation of these regulations. I say this for various reasons,

foremost perhaps being that the CDM Regulations are generally considered necessary and efficient in the construction industry. Moreover, in the event that the government does decide that fresh legislation is required, such legislation will surely be a low priority for the government at least in the initial period following the UK's exit from the EU. It is worth noting here also that most construction contracts do include change-of-law provisions to deal with statutory updates. Consequently, I think it is safe to say that at this moment in time amendments to construction contracts dealing explicitly with changes to the CDM Regulations as a result of Brexit are unlikely to be warranted.

Pertinent issues

Some thought may be necessary, however, in light of the jurisdictional implications of an EU exit deal for the UK. Additionally, we cannot ignore the potential ramifications of predicted labour shortages and a possible increase in import levies. These are the issues that should be considered when drafting contracts for projects that may stretch past the date on which a deal is struck for the UK's departure from the EU.

Drafting jurisdiction clauses

At present the EU's aim is to harmonise EU contract law. The UK's membership in the EU provides us with a seat at the negotiating table at which the framework of such law is established. At the root of discussion is whether the harmonised law will be based on a continental model or on common law. So far the UK has used its position in negotiations to steer away from the view that EU contract law should

Regulation has not been transposed into UK law.

The UK may seek to maintain its rights in the Brussels Regulation. However, in the absence of certainty as to whether it will be able to ensure this, a cautious approach may well be to opt for arbitration.

If a crucial party in a construction project is situated in an EU member state, then it may well be prudent to include corresponding provisions in

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come under the former approach to create a 'European Commercial Code'. Should such a code come into being then the likelihood is that the choice of preferred governing jurisdiction in European contracts is likely to change from English law to the European standard.

Initially this change is more likely to be seen in financial services contracts. For short-term construction contracts during the transitional period, the impact on drafting and negotiation of jurisdiction clauses may well be minimal. However, for projects stretching past or likely to stretch past 2019 – and especially where there is a European element to the works and/or a European funder, including where parties are located in EU member states – the jurisdiction preference may well change. This should therefore be borne in mind when considering relevant wording for jurisdiction clauses.

Litigation or arbitration?

The Brussels I Convention succeeded by the Brussels Regulation, which essentially governs jurisdiction and enforcement for civil and commercial matters, is a key reason for many UK construction parties to opt for litigation rather than for arbitration when contracting with EU parties based overseas. Unlike other conventions, such as the Lugano Convention, the Brussels

all contracts for the wider project team so as to ensure uniformity.

Contract price increases and contingencies

Since the vote to leave the EU was confirmed on 23 June 2016, currency markets have been affected and we have already seen a devaluation of sterling. Depending on the deal that the UK is able to negotiate, import levies from EU member states may also increase. Conversely, the use of overseas suppliers by UK developers and contractors may mean higher costs exacerbated by a weakened exchange rate.

Potentially the UK could also see a decrease in construction workers hailing from EU member states migrating in for work in the sector, whether due to restrictions on free movement of persons or less attractive salaries due to a devalued currency. With a predicted 230,000 new jobs, both skilled and unskilled, anticipated between 2016 and 2021 (The Construction Industry Skills Training Board, January 2016), there is a real concern as to how an increase in labour demand will be satisfied.

Membership of the EU has also seen the UK benefit from European Investment Bank loans. Without access to these important capital injections, infrastructure deals may be endangered and an increase in public funding required.

It is worth mentioning here also that the UK will likely lose the benefit of any trade agreements that the EU has agreed or will agree with other countries.

Safeguarding parties to construction contracts against the risk posed by such financial ramifications will require consideration of certain provisions

be attractive, especially to contractors. Under a fixed-cost contract, in the event that costs increase in the wake of the UK's EU exit, contractors would be unlikely to successfully claim extra costs against the contract sum. Clearly this scenario may appear attractive to employers. However as fixed-priced contracts become less attractive to contractors and depletion of tender

the most recent 2016 update to this contract has deleted a number of the price variation options. This decision may well have been made prior to 23 June 2016. Negotiations of fluctuation provisions may therefore begin with a look back to the provisions as previously drafted, tweaking them to fit the particulars of each project. For instance, prices may be linked to inflation or provide for relief if materials and/or labour prices increase. Links to trade indices may also be worth consideration.

Clearly the mechanics of fluctuation provisions should not be ignored when negotiating such bespoke amendments. For instance, each party will need to be clear on the specifics of indices used and quantity surveyor services should include provision for the scheduling of related costs.

With uncertainty surrounding build costs, fluctuation provisions may be attractive, especially to contractors.

already provided for by standard contracts, as well as the potential inclusion of new bespoke clauses.

Fluctuations

Currently fixed-price contracts are notably present in the construction industry. With uncertainty surrounding build costs, fluctuation provisions may

bids occurs, employers may well find themselves having to consider building in fluctuation provisions to suit the parties' requirements.

JCT D&B fluctuation provisions

The JCT D&B contract includes fluctuation provisions that are often disapplied. Interestingly,

Risk allocation

On a broader level, consideration should be made during the negotiation of construction contracts as to who will shoulder the risk should price increases arise. A well-advised contractor will most likely want to carve out any risks attributable to changes in law that emanate from an unfavourable UK exit deal. On the other hand, the employer may argue that the onus should sit fully with the contractor on the basis that it is best placed to assess any inflation in pricing difference and change to the availability and price of labour.

Termination provisions and the 'Brexit clause'

Pre-existing construction contracts

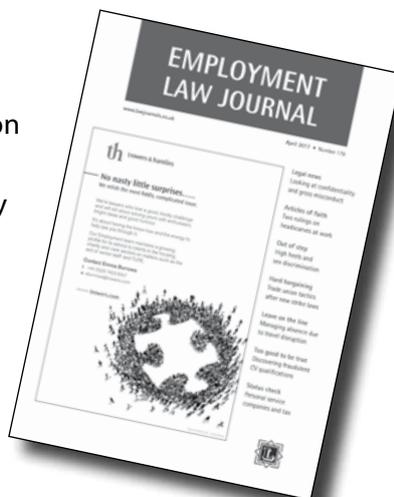
Parties to pre-existing construction and development finance agreements may well seek to exit certain contracts, for instance, due to uncertainty of profitability, in which case they will of course need to consider the agreed terms of the contract to determine whether termination is in fact possible. In such circumstances express or implied termination provisions, a material adverse change provision, a force majeure clause or even reliance on the doctrine of frustration should be looked to when contemplating the most viable option. For instance,

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depending on how the clause has been drafted, the economic impact of Brexit on the construction project due to trade shortages and currency fluctuations, as outlined above, may well be sufficient to trigger a material adverse change clause in a development finance agreement.

A force majeure clause would be more difficult to satisfy, however, there may be circumstances extreme enough to warrant its enforcement. For example, in a scenario where due to Brexit a party to the contract is no longer authorised to provide its services within the EU.

Future construction contracts

Clearly terminating a building contract during the course of a project might appear to be a rather extreme approach and one should hope that concerns will be managed on a project-by-project basis as costs increase. Nevertheless, when drafting construction contracts clear termination provisions may be considered valuable to ensure that a contracting party is provided with a clear exit route should the construction project being undertaken be compromised by the economic impact of Brexit.

An express right to terminate in a certain economic climate may operate effectively, however, the procedure for invoking such a termination right will need to be considered carefully and each party will need to be fully versed as to how termination will operate.

A bespoke ‘Brexit clause’, drafted to come into effect in the event that a contract becomes undeliverable due to the UK ending its EU membership, might have some merit. A straightforward clause stating that the dissolution of the contract may be triggered when the UK ‘terminates its membership in the European Union’ may not in fact have the required effect as we do not know whether there will be a transitional period after the formal exit of the UK in which EU laws will continue to apply. However, a clause drafted so as not to be radically different to a material adverse change clause, which is tailored specifically to address the relevant concerns of each contracting

party for the project at hand, may well be worthwhile.

Undoubtedly the outlining of potential trigger events for a Brexit clause will require an understanding of the project and real consideration as to the events that would be likely to cause issue. As a general example, however, the trigger-event wording might look something like this:

This clause may be triggered in the following circumstances:

Consideration should be made during the negotiation of construction contracts as to who will shoulder the risk should price increases arise.

- (a) in the event that tariffs are imposed upon the sale, licensing or other transfer of the Specified Materials from the United Kingdom to a member state of the European Union; and
- (b) in the event that a change in the laws applicable at the date of this agreement is such that the Contractor is no longer entitled by law to provide its services within the United Kingdom.

The clause should also explain, as clearly as possible, how and when it may be invoked. Accordingly, to ensure a lack of ambiguity a Brexit clause should:

- clearly identify all relevant Brexit-related events that will be deemed to trigger it – for example, regulatory change, the imposition of additional or inflated import tariffs, or specified exchange rate movements;
- outline all contractual consequences of the stated events – for instance, termination, delay or cost implications; and
- outline or refer to a procedure to enforce the clause.

Summary for practitioners

- In the period of uncertainty surrounding the deal that the

UK will eventually make with the EU to secure its exit, parties to construction contracts should consider whether sufficient mechanisms are in place to deal with price increases and jurisdiction implications when negotiating agreements.

- In pre-existing contracts, termination provisions should also be scrutinised to determine whether it is in fact possible for

parties to walk away in the event that a project becomes unviable.

- For new contracts a bespoke Brexit clause may be desirable, drafted to come into effect in the event that a contract becomes undeliverable due to clearly specified circumstances and with a carefully considered procedure for implementation.
- Consideration during the negotiation stage of construction contracts should be made as to who will carry the risk if materials and labour prices increase. The contractor may well be best placed to assess any inflation in pricing difference and change to the availability and price of labour, however, each party will need to be clear on the specifics of indices used and quantity surveyor services should include provision for the scheduling of related costs.
- Such foresight will be especially sensible for projects that are likely to run for a period in excess of two years, however, shorter-term projects may also benefit from a consideration of the above provisions in light of the current economic climate. ■