



As the Procurement and Property Functional Leader, I am pleased to introduce this guidance to help government agencies support the construction sector during the COVID-19 lockdown period:

Guidance for public sector agencies dealing with variation claims due to the COVID-19 lockdown period

These guidelines are intended for all internal and external project leads within government agencies and relate to NZS 3910:2013 contracts.

On 7 April, MBIE released guidance on the contractual implications for construction projects of the COVID-19 lockdown period, which can be found on the [Construction Sector Accord website](#) on the COVID-19 guidelines, information and practice page.

That guidance clarified the government's interpretation of the position under general conditions of NZS 3910:2013 contracts, subject to specific contract conditions, which is that contractors are entitled to relief for delay and to recover certain Costs resulting from the lockdown period.

Establishing a right to a variation is only the first step in dealing with the commercial and legal implications of the lockdown. Next, the value of the variation will need to be established, which will require complex analysis on a project-by-project basis.

This guidance has been developed to help agencies work through the complexities of the valuation processes in a fair and consistent manner.

In this guidance, 'lockdown period' refers to the COVID-19 Alert Level 4 lockdown which began on 26 March 2020, and not to restrictions under any other alert levels. .

If you are unsure about how this guidance applies to any of your individual NZS 3910:2013 contracts, please seek specific legal advice.

Basis of the entitlement to a variation

This guidance primarily considers the contractual position in relation to variation claims arising under general condition 5.11.10 (the 'change of law' provision) with reference to the lockdown period.

At the beginning of the lockdown period, many agencies issued instructions for on-site contract works to be suspended, or entered into mutual agreements to suspend the works under general condition 6.7. While different considerations may be relevant to a suspension, the principles below should generally still apply.

While in many cases establishing the value of the variation for the lockdown period will be the most material concern for both agencies and contractors, it is only part of the discussion that parties will need to have. Issues related to the value of the variation, extensions of time and time-related costs will also require careful consideration.

To paraphrase general condition 5.11.10, if the change of law increases or decreases the '*Cost to the Contractor of performing the Contract*', then that increase or decrease is to be treated as a variation. Consequently, in relation to the particular contract under consideration, an assessment of the variation needs to take into account any increase,

decrease or both in the *'expense or loss and overhead cost, whether on or off the Site'*¹ incurred by the contractor in performing the contract as a result of the change in law.

This means the full Cost consequences of the lockdown, including any wage subsidies or other government support that will benefit contractors or the supply chain, must be taken into account in agreeing the value of the variation.

Due to the complexity of the COVID-19 situation, the parties are encouraged to reach agreement on the Cost and time consequences of variations where possible. This should be with a view to reaching an equitable outcome for both parties, being **an outcome that ensures that the impact of COVID-19 is distributed fairly across all parties to the project, in the best interests of the project and in the context of the project.**

Where agreement cannot be reached in a timely fashion, matters in disputes should be escalated through the usual mechanisms and in accordance with the terms of the contract.

Principles to guide the approach to valuing variations

To support contractors affected by the lockdown, all agencies **must** be guided by the following principles:

- Discussions and problem-solving should occur between agency and contractor project teams in parallel with the contractual claims valuation processes.
- Agencies should treat all claims equitably by adopting a fair and reasonable approach to the valuation of substantiated Costs.
- Submissions and responses must be undertaken in a transparent, open and collaborative manner. Each project should be managed on a case-by-case basis to address the individual circumstances of the project, with a focus on reaching mutual agreement on solutions that are tailored to those circumstances.
- Agencies need to work cooperatively with contractors to seek solutions that maximise the chances of achieving good project outcomes for clients, contractors, subcontractors, employees and suppliers.

As a matter of reciprocity, contractors will be required to:

- Understand that the efficient resolution of the variation will be reliant on the contractor developing a submission that provides evidence and justification for any increase in Cost as a result of the lockdown. Contractors need to put appropriate effort into substantiating actual Costs including diligent record keeping and open and constructive correspondence.
- Fully disclose any decrease in Costs, including any support or benefit they (or their supply chain) have received from government (such as the wage subsidy), on a commercial basis (eg under a lease), insurance or otherwise, in relation to COVID-19 (including the lockdown) and account for this support or benefit when making a claim.
- Mitigate delays and Costs, demonstrate flexibility in doing so, and promptly provide information on anticipated additional costs, delays and strategies.
- Seek agency flexibility and cooperation only for matters related to the lockdown, and not for pre-existing project issues or unrelated delays.
- Protect and utilise insurance arrangements that can mitigate impacts.
- Act cooperatively with other contractors on the project.
- Treat subcontractors, consultants, and suppliers in a manner that is consistent with all of the principles outlined above.

Valuing the variation for the lockdown period

Under general condition 9.3.2, the onus is on the contractor to notify the proposed value of the variation and to provide full details to support its claim.

Under general condition 9.3.4, the value should as far as possible be determined by agreement between the contractor and the Engineer to the Contract. Where they cannot agree, the value should be determined by the

¹ Refer to definition of "Cost" in NZS 3910. References to 'Cost' in this guidance are references to this defined term.

Engineer. This guidance highlights some key principles that the parties should take into account in seeking to agree the value of the variation, or for Engineers to take into account if a determination is required.

In most cases the valuation will involve calculating:

- Direct Costs by way of increases or decreases in Costs associated with performing the contract beyond the Costs already contemplated in the contract and that have been actually and reasonably incurred or realised as a result of the lockdown period (plus non-time-related overheads); and
- Time-related Costs, being, essentially, time-related on-site overheads and off-site overheads and profit.

Direct Costs

There are a range of scenarios that may occur in a project as a result of COVID-19, including the lockdown period. Below are some of the items agencies should anticipate receiving claims for and be considering as part of its discussions with the contractor.

Demobilisation, remobilisation and materials

A variation claim is likely to include the Costs of demobilisation and remobilisation, making the site safe and other temporary works required as a result of the lockdown. Where the claim relates to additional work carried out, these Costs should be relatively easy to ascertain between the parties as they are likely to have been incurred in the two days leading up to the lockdown (i.e. on 24 and 25 March when New Zealand was in COVID-19 Alert Level 3) and following the lockdown when the site was re-opened.

It is also possible that the lockdown may have had an impact on the contractor's supply chain, for instance a delay in delivery of materials that results in extra off-site storage costs. Costs of this nature should be recoverable by the contractor.

Plant and equipment

There is likely to be an increase in plant and equipment Costs as a result of the lockdown. Some contractors may have managed to off-hire and remove loose plant and equipment from site prior to the lockdown, but given the time constraints, this may not have been possible.

Items such as scaffolding, cabins, site security, fencing and other semi-fixed temporary plant are likely to have been left on site. These could incur hire charges during the lockdown, contributing to an overall increase in Costs.

In each case, it should be verified whether these are covered by the working day rate, where applicable. (Noting that this is unlikely for scaffolding which is now often regarded as a trade and not an on-site overhead or set up cost).

Generally, payments for plant and equipment beyond that necessary for the performance of the contract should not be compensable. It is possible contractors may seek to justify additional costs as a valid variation, in particular where keeping items on hire could assist in a return to full productivity on site. These claims are more appropriately considered as a time-related cost and will need to be considered on a case by case basis, taking into account the facts of the situation.

Damage during lockdown

With the speed of implementation of the lockdown, in some instances the preventative measures and protections put in place by the contractor may not have been adequate to prevent damage during the lockdown period.

However, the contractor remains responsible for the care of the contract works and all plant during the lockdown and they will not be able to recover the cost of rectifying damage due to things such as adverse weather, vandalism and graffiti. The contractor may be able to claim the cost of repairing any damage that has occurred under relevant insurance policies.

Lockdown rules allowed for security services to be provided on sites that were not linked to essential services, and the contractor will be able to claim the direct cost of these services. Where the contractor was prevented from carrying out necessary protective works as a result of the lockdown, then the Costs of rectifying works damaged directly as a result (e.g. burst pipes, damage to facades) may be recoverable where claims are able to be justified.

Trade labour

There are currently divergent legal views on the extent to which the costs associated with maintaining staff during the lockdown are directly compensable as part of the value of a variation entitlement.

In the case of a variation arising under general condition 5.11.10, the government's interpretation is that the principal *is not* required to effectively indemnify the contractor for all Costs associated with the lockdown. What is compensable is an increase in the Costs incurred by the contractor in performing the Contract beyond that contemplated in the contract.

As with all other heads of Cost, increases in labour Costs will need to be substantiated and proven by the contractor on an open-book basis. While some increases in labour Costs will clearly be attributable to both the specific contract and the lockdown, for others the link will not be so clear. Agencies will need to carefully consider whether the increases in Costs that are being claimed are a *reasonable actual increase in expense or direct cost to the contractor* as a result of the lockdown.

Where trade labour is not employed directly but engaged through subcontractor arrangements, the nature of the arrangements is of relevance. This will include whether under the terms of the subcontract, the contractor has incurred a *reasonable actual increase in expense or direct cost* as a result of the lockdown. It is noted that under many standard subcontract arrangements, contractors are unlikely to be liable to subcontractors for any costs associated with idle labour.

Notwithstanding the government's interpretation of the contract, agencies are reminded that the risk of contractor, sub-contractor and supplier insolvency is significantly increased due to COVID-19, with the potential to substantially and negatively impact both the industry and projects.

Agencies are encouraged to treat those in their supply chain with due regard and make efforts to minimise the stand down impact on the liquidity of those businesses. This is likely to require going beyond the strict terms of the contract in some cases.

Time-related Costs

The Government's directive to treat the lockdown as a variation will trigger an entitlement to an extension of time under general condition 10.3.1(a) (likely for the full duration of the lockdown) and an entitlement to time-related Costs.

General condition 9.3.11 provides that '*the Contractor shall be entitled to compensation for the time-related Cost incurred in relation to that extension together with an allowance for profit*'. The time-related Cost component is assessed by either a working day rate (WDR), or on the basis of reasonable compensation for time-related on-site overheads and off-site overheads and profit.

Given the unique nature of the lockdown period, and the unprecedented change to the way in which all work has had to be carried out, it is highly unlikely that any WDR in the contract will reflect the actual increase or decrease in time-related costs associated with any delay. As a result, parties should try and agree on a reasonable and equitable approach.

Depending on the circumstances, an example of an equitable approach might involve agreeing actual incurred on-site overheads and then agreeing a suitable allowance for off-site overheads including profit. Again, actual costs would need to be substantiated and proven by the Contractor, preferably on an open-book basis.

Items that would typically be included as on-site overheads

- Remuneration and expenses for management, administration, routine staff, supervisory staff associated with the running of the site (excluding working foremen and leading hands) – the rates should be established on the actual costs for the staff, including KiwiSaver contributions, annual leave provisions, statutory holidays, sick leave, ACC levies and insurances, fringe benefits, clothing and other allowances.
- Insurance premiums / bond extensions.

- Site and temporary works and facilities – such as hire of office cabins, shelters, canteens, ablutions and toilets, security fencing, alarms (if applicable), scaffolding, craneage and other heavy plant, office equipment and communications.
- Other actual site-related costs, such as power and services running costs.

Items that would typically be included in off-site overheads and profit

Off-site overheads and profit will typically include the general running costs for the contractor's business, including administrative, financial and overhead costs for head office, and other off-site overheads dedicated to the contract. Again, any government benefit or commercially agreed arrangement arising out of the lockdown (including the Government's Wage Subsidy Scheme or similar benefit, or any rental abatement on head office lease costs) should be offset or deducted from these actual costs. In order for these to be recoverable, appropriate substantiation and apportionment between contracts will be required so that an equitable outcome can be achieved. In this regard, any nominated off-site overhead percentages in the contract may be referred to on an indicative basis.



Carolyn Tremain
Chief Executive
Ministry of Business, Innovation & Employment