

## Price escalation and FIDIC: is Force Majeure an answer?

Written by Joanne Clarke

Could provisions in FIDIC contracts giving relief for 'Force Majeure' or 'Exceptional Events' provide relief to contractors suffering as a result of price escalation?

### Global construction costs in 2022

It is well documented that construction and engineering projects around the globe are being affected by extreme and sometimes unprecedented price escalation. This is for many reasons including the Covid-19 pandemic and the Russo-Ukrainian conflict.<sup>1</sup>

Contractors are looking to their contracts and the governing law of those contracts to find ways to avoid, spread or share the risk of this price escalation.

For contracts based on FIDIC conditions, the provisions in Sub-Clause 13.7 [*Adjustments for Changes in Legislation*] and/or Sub-Clause 13.8 [*Adjustments for Changes in Cost*] could be an answer.<sup>2</sup> This article focuses, however, on whether an (another?) answer may be found in the 'Force Majeure' or 'Exceptional Events' provisions.

### Force Majeure under FIDIC 1999

Under the FIDIC 1999 forms of contract, if either party is prevented from performance of its obligations by Force Majeure ('FM') then, subject to giving notice, it may be excused performance of those obligations. The contractor may also be entitled to an extension of time and/or cost.

#### Definition of FM

Sub-Clause 19.1 contains a definition of FM. It is '*an exceptional event or circumstance (a) which is beyond a Party's control, (b) which such Party could not reasonably have provided against before entering into*



Joanne Clarke

Partner

T +44 (0)20 3755 5732

[joanne.clarke@howardkennedy.com](mailto:joanne.clarke@howardkennedy.com)

*the Contract, (c) which, having arisen, such Party could not reasonably have avoided or overcome, and (d) which is not substantially attributable to the other Party'.*

For the definition to be met, these five criteria ('exceptional event or circumstance' plus the criteria (a) to (d)) must be satisfied.

The '*exceptional event or circumstance*' might be the price escalation itself or something else, such as the Russo-Ukrainian conflict or Covid-19, the effect of which is price escalation, and there is scope for argument on this point.

It has been noted in respect of current price escalation in the construction sector that for some countries

prices, higher shipping costs, and supply shortages have caused this strong price growth. Some of the key materials [with] significant price increases include structural steel beams, reinforcing steel, softwood timber for framing, copper pipe and copper cable.'

<sup>2</sup> The equivalent provisions in FIDIC 2017 are at Sub-Clauses 13.6 and 13.7 respectively.

<sup>1</sup> For information about the various causes and effects see the Turner & Townsend report on its 'International construction market survey 2022' here: <https://www.turnerandtowntsend.com/en/perspectives/international-constructionmarket-survey-2022/> (last visited 21 July 2022). The report states that, in the 2022 survey results, 38 geographical construction markets suggested that they experienced inflation of 10% or more. Also 'Rising building material costs have been one of the key drivers of higher construction cost inflation over the last 12 months. Global supply-chain disruptions, high commodity



*'these are some of the highest rates of inflation we have seen in decades, yet not in the hyperinflationary territory of the Weimar Republic in Germany following World War I, or Zimbabwe from 2007 to 2009'* and *'Whilst the definition of hyperinflation is loose, for it to materialise, we'd expect significant increases to inflation on a month-on-month basis, above double-digit growth.'*<sup>3</sup> On this basis, it could be argued for some countries that price escalation as currently seen is not exceptional.

If price escalation is the *'exceptional event or circumstance'*, it seems likely that (a) and (d) above will also be satisfied unless, for example, the party in question is a Government with control over or responsibility for the price escalation. Regarding (b) above, the provisions that a contractor can make before entering the contract are generally limited to price and planning and in Sub-Clause 19.1 are expressly limited to what is *'reasonable'*. Foreseeability is not part of the definition. The fact that a contractor may be able to foresee price escalation before entering the contract will not be relevant if nonetheless the contractor could not reasonably have provided against it. Item (c) above, which refers to the event having arisen not being *'reasonably ... avoided or overcome'*, appears to exclude from FM an event/circumstance whose effect could reasonably be completely negated. The fact that the effects of an event/circumstance can (or should – see below) be mitigated does not mean that the event cannot be FM.<sup>4</sup>

Sub-Clause 19.1(i) to (v) contains a list of example events or circumstances which, if they otherwise satisfy the definition, could constitute FM. Price escalation (or volatility) does not appear on this list but this is not fatal if it otherwise satisfies the definition. The real significance of this list is that four of the events listed may (subject to other criteria) give the contractor entitlement to money as well as time. If an event – such as price escalation – is not listed there will be no monetary compensation for it (see below).

### **The requirement for prevention**

If the price escalation in question were to satisfy the definition of FM, it would only have contractual effect

<sup>3</sup> See the Turner & Townsend survey report at footnote 1 above in the section 'Global economic outlook'.

<sup>4</sup> See further Corbett & Co 'FIDIC 2017: A Practical Legal Guide' (2020) Clause 18.

– and so be of use to the affected party – if it were also to prevent the affected party from performing any of its obligations under the contract.

This requirement for prevention is set out in two provisions.

Sub-Clause 19.2 provides that if a party *'is or will be prevented from performing any of its obligations under the Contract'* by FM, it shall give notice and *'shall specify the obligations, the performance of which is or will be prevented'*. Having given notice, the party shall *'be excused performance of such obligations for so long as such [FM] prevents it from performing them'*.<sup>5</sup>

Sub-Clause 19.4 provides that if the contractor *'is prevented from performing any of his obligations under the Contract by [FM] of which notice has been given [under Sub-Clause 19.2] and suffers delay and/or incurs Cost by reason of such [FM]'* then the contractor shall be entitled subject to Sub-Clause 20.1 to an extension of time for any such delay and, in limited circumstances, to additional cost.

These provisions refer to the prevention of *'any'* obligations<sup>6</sup> so a shutdown of the whole project is not necessary

If the price escalation falls within the definition of FM set out above, are there circumstances in which it might prevent performance? It is easy enough to see how price escalation may make it more onerous for a contractor to perform its obligations or may cause delay or disruption but at what point can it be said that the price escalation is preventing the contractor's performance?

In English law, prevention has been interpreted in the context of force majeure as meaning physical or legal prevention and not mere economic unprofitability.<sup>7</sup> The position may be different in other jurisdictions.

What if the scale of the loss resulting from the price escalation means that a contractor cannot continue to trade? Clearly there is scope for argument about the tipping point after which prevention may occur and that point will be different in each case. It is

<sup>5</sup> This excuse from performance does not apply to the obligation of either party to make payments to the other party under the contract.

<sup>6</sup> Sub-Clause 19.4 of the MDB Harmonised Edition (June 2010) refers to *'substantial obligations'*

<sup>7</sup> *Tennants (Lancashire) Ltd v. G.S. Wilson & Co Ltd* [1917] AC 495.



suggested, however, that it will usually be difficult to show prevention because of price escalation alone.

## Entitlement to time and/or cost?

If a contractor is prevented from performing obligations under the contract by FM, has given notice, and suffers delay or incurs Cost by reason of such FM, Sub-Clause 19.4 provides that the contractor shall be entitled subject to Sub-Clause 20.1 to an extension of time and – if the event or circumstance is of the kind listed in Sub-Clause 19.1 sub-paragraphs (i) to (iv) (and in the case of sub-paragraphs (ii) to (iv) occurs in the Country<sup>8</sup>) – to payment of such Cost.

In other words, FM and prevention will only entitle the contractor to an extension of time, unless the FM is on the list of causes giving rise to Cost. These causes include war and, if it occurs in the Country, terrorism, strikes, munitions of war (etc).<sup>9</sup>

A contractor may therefore be entitled to an extension of time for delay caused by price escalation (or Covid-19) if this otherwise satisfies the definition of FM and prevents the contractor, but not to payment of Cost, which would only be available (in the context of the present article) if the contractor can show instead that the FM is war.

## Mitigation

Sub-Clause 19.3 requires each party to use '*reasonable endeavours*' to minimise delay resulting from FM. It does not require mitigation of any other consequence, although most legal systems will require mitigation as a general principle. In terms of price escalation, were this to constitute FM, '*reasonable endeavours*' might include changing suppliers or transport options, although of course that may not be possible or may have no effect if there is price escalation across the board. The usual rule, subject to the governing law, is

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<sup>8</sup> 'Country' is defined in Sub-Clause 1.1.6.2 as the 'country in which the Site (or most of it) is located, where the Permanent Works are to be executed'.

<sup>9</sup> See Sub-Clause 19.1 for the complete list.

<sup>10</sup> Although unlawfulness might arise if, for example, one party to a contract is prohibited from continuing a contractual relationship with the other party as a result of sanctions.

<sup>11</sup> See Knutson 'FIDIC An Analysis of International Construction Contracts' (Kluwer Law, 2005) at p237 in relation to the law of Malaysia and the reference to *Kung Swee Heng v. Paritam Kaur* [1948] M.L.J. 170 in which Hill J referred to the definition adopted by the American Law Institute: 'Impossibility means not strict impossibility but impracticability because of extreme and unreasonable difficulty, expense, injury or loss.'

that mitigation does not require a party to incur additional cost. The parties may agree, in the interests of the project, to overcome price escalation by changing for example the physical works to avoid, reduce or share the impact of costly items.

## No FM but obligations unlawful or impossible

Sub-Clause 19.7 provides that if an event/circumstance outside the control of the parties, which is not necessarily FM, makes it impossible or unlawful for either or both parties to fulfil its/their contractual obligations or which, under the governing law allows the parties to be released from further performance of the contract then, upon notice, the parties shall be discharged from further performance.

It is difficult to see how price escalation could make it unlawful for a party to fulfil its contractual obligations.<sup>10</sup> Whether price escalation makes it impossible for a party to fulfil its obligations may depend on the meaning given to the word '*impossible*' in the relevant jurisdiction (it may for example, encompass impracticability because of extreme and unreasonable expense or loss<sup>11</sup>) and the facts (in respect of which there may be a tipping point as mentioned above).

## The governing law

A key consideration with price escalation is likely to be the governing law, which should specifically be considered in the context of Sub-Clause 19.7 and also in general, since it may provide relief from performance in case of price escalation under a variety of principles. These may include exceptional (or changed) circumstances,<sup>12</sup> hardship<sup>13</sup> or impracticability<sup>14</sup>. The law of some jurisdictions may consider run-away inflation to be a frustrating event which may be remedied by release from performance.<sup>15</sup> Again, each case will be considered on

<sup>12</sup> Meaning events or circumstances which, without rendering the performance of an obligation impossible, make it excessively onerous to a point of breaking the economic equilibrium of a contract. In this case, the court (tribunal) may reduce the obligation in question to reasonable limits. See Knutson 'FIDIC An Analysis of International Construction Contracts' (Kluwer Law, 2005) at p34 in relation to the law of Egypt.

<sup>13</sup> See Klee 'International Construction Contract Law' (Wiley, 2015) at p40 in relation to the law of Brazil and Germany.

<sup>14</sup> See Klee 'International Construction Contract Law' (Wiley, 2015) at p41 in relation to US cases.

<sup>15</sup> See Knutson 'FIDIC An Analysis of International Construction Contracts' (Kluwer Law, 2005) at p183 in relation to the law of India.



its merits. A court (tribunal) may consider price escalation to be a normal business risk such that relief is not available.

## Exceptional Events under FIDIC 2017

In the 2017 forms, FIDIC does not use the term '*Force Majeure*' and instead uses the term '*Exceptional Events*'.<sup>16</sup> The requirement for the event or circumstance to be 'exceptional' no longer features in the definition. Apart from this, the provisions in FIDIC 2017 are largely similar to those in FIDIC 1999 and so the considerations identified above will continue to apply.

## Conclusion

Whether price escalation affecting a contract based on the FIDIC conditions constitutes FM or an Exceptional Event will need to be assessed on the wording of the relevant provisions (which may include amendments to the standard FIDIC wording) and the facts of each case. Even if price escalation were to fall within the contractual definition of FM, a contractor may struggle to show that it has been prevented from performing its obligations under the contract by FM rather than performance of those obligations simply being rendered more onerous. Even then, as price escalation is not on the list in Sub-Clause 19.1, the contractor will not be entitled to compensation for it (i.e., payment of Cost) but only (if the contractor suffers delay) to an extension of time.<sup>17</sup> Parties to construction and engineering contracts that are affected by price escalation should take advice on the governing law of their contract as that may provide relief in case of exceptional circumstances or similar. For future contracts, parties will wish to address the issue of price escalation up front, including by considering their supply chain and procurement strategies, and by drafting contractual provisions to address this risk as necessary.

**Please get in touch**  
**joanne.clarke@howardkennedy.com with your**  
**thoughts or to discuss any concern**

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<sup>16</sup> Clause 18 of the Red Book 2017.

<sup>17</sup> Subject to compliance with notice requirements.

