Chronique – Inflation and Shortages of Labour and Materials in Lump-Sum Construction Contracts: Who Has to Pay?

Summary

The authors consider the impact of unanticipated increases in the prices of materials plus labour and material shortages on the obligations of the parties involved in lump-sum contracts. They address these issues in light of recent cases where contractors have argued that the exceptional circumstances arising from the COVID-19 pandemic warrant an increase in the contract price or justify delays. Since the case law on those issues is rather limited, the authors suggest additional answers by relying on the principles surrounding the concept of force majeure and the requirements of good faith in Quebec civil law.

INTRODUCTION

Since the onset of the COVID-19 pandemic, everyone involved in the construction industry has faced unprecedented disruption due to delays in delivery, skyrocketing material prices and a shortage of skilled labour. While some people believe that delivery times should improve in the short run and that inflation has reached its peak, it is highly likely that the problems related to rising material and equipment prices, labour shortages and overheating in the construction sector will continue to plague customers, contractors, suppliers of materials and professionals in the years ahead.

These disruptions pose a particular challenge in cases involving lump-sum contracts, where the prices offered by contractors and suppliers should allow some leeway for the risks associated with the project in order to provide customers with budget certainty, while at the same time allowing the contractors to make a profit. Work delays are increasingly caused by the contractors' or subcontractors' lack of manpower, a factor that was not foreseen when the contract was signed. Who should bear the financial risks associated with those problems? Could such circumstances amount to force majeure and thereby release the contractor from his obligations?

Although there are few precedents on those issues in Quebec law, and it will always be necessary to consider the specific content of the contract and the particular facts of each case, some answers may be gleaned by following the general principles of contract law and a few relevant precedents.

To consult the French text, see Nicolas-Karl PERRAULT and Christine PROVENCHER, « Chronique – L'inflation et la pénurie de main-d'œuvre et de matériaux dans un contrat de construction à forfait : qui doit payer ?», in *Repères*, June 2022, *La référence*, EYB2022REP3482.

I– UNEXPECTED INCREASES IN THE PRICES OF MATERIALS AND LABOUR

Unless the contract specifically provides for such changes, contractors may not demand increases in the price of a lump-sum contract.[1] Lump-sum contracts in the construction industry rarely allow contractors to claim an increase in the contract price due to market conditions, including an increase in the price of materials or labour. In principle, therefore, contractors cannot invoke inflation to renegotiate the agreed lump-sum price; they must assume the financial risk associated with an increase in the price of materials unless the parties have chosen to include an inflation-related price adjustment clause in the contract.[2] The inclusion of such clauses is now becoming increasingly common given the volatility of material prices. It would be a sound idea for all large-scale long-term projects.

A. Can a contractor facing a dramatic increase in the price of materials after the contract has been signed invoke force majeure to force the customer to renegotiate the price?

This argument was discussed in *Métal APS inc.* c. *Ventilabec inc.*[3] where a supplier of ventilation materials claimed payment of unpaid invoices. Ventilabec inc. refused to pay the amount claimed by APS on the ground that it was a lump-sum contract subject to a billing limit. APS argued that the steep increase in the price of steel after the contract was signed amounted to force majeure, which would set aside its obligation to abide by the maximum billing price agreed between the parties.

Justice Patrick Buchholz, J.S.C., concluded that APS had not submitted any evidence that the increase in the price of steel had affected its actual capacity to deliver the merchandise. He also found that the parties had discussed the significant increases in the price of raw materials and had come to a transaction in this regard. The Court ruled in favour of Ventilabec, finding that APS could not claim amounts that exceeded the agreed maximum price, despite its arguments regarding the increased price of steel.

This judgment and the lessons learned from the case law on force majeure in Quebec law suggest that it will generally be very difficult for contractors or suppliers of materials to prove that an increase in the price of materials or labour may amount to force majeure in the absence of a specific contractual provision to that effect. It is interesting to note that standard lump-sum contracts drawn up by the Canadian Construction Documents Committee (CCDC) or the Canadian Construction

Association (CCA) do not refer to inflation or other changes in market conditions among the circumstances that may constitute force majeure.

In the absence of a contractual definition, or faced with an incomplete definition of force majeure, the courts will use the definition of force majeure provided in article 1470 C.C.Q. Under the second paragraph of article 1470 C.C.Q., an event must be both unforeseeable and irresistible in order to constitute force majeure [referred to as “superior force” in the English version of the Code].

“Unforeseeability” means that the parties could not have foreseen the event at the time they concluded the contract. That does not mean that the event may never have happened before. The test is whether a reasonable person in the same situation could have foreseen the event.[4]

“Irresistibility” is when a reasonable person in the same circumstances would not have been able to take reasonable measures to prevent the event from occurring. Both the doctrine and the case law consider that “irresistibility” also means that the event causing the harm must make it absolutely impossible for the debtor to perform his obligations. The irresistibility requirement is not met when it merely becomes more difficult, perilous or costly to perform the debtor’s obligation.[5]

In addition, the irresistible and unforeseeable event must be outside the scope of activities for which the defendant is usually responsible.[6] Lastly, the evidence must show that a defendant who invokes force majeure was not negligent.[7] The defendant must therefore be able to demonstrate that it behaved irreproachably if it wants to rely on force majeure to escape liability.

While it is conceivable that the dramatic increase in the price of raw materials since the COVID-19 pandemic started could be regarded as an unforeseeable event for contractors who agreed to a lump-sum contract before it struck, price volatility is today more likely to be a known reality that the parties need to provide for.

In any event, and in accordance with the court’s reasoning in *Métal APS inc.* c. *Ventilabec inc.* cited above, the increase in the price of materials and labour will not generally be considered an “irresistible” event as defined by the case law, since it does not make it absolutely impossible for the debtor to perform his obligations. In reality, the contractor can still do the work, even though inflation has the effect of reducing or even wiping out his profit margin.

B. Can good faith be invoked to force a renegotiation of the contract?

The possibility for a party to demand that the terms of a contract be renegotiated due to changing market conditions in the absence of a contractual obligation was addressed by the Supreme Court of Canada (SCC) in *Churchill Falls (Labrador) Corp.* v. *Hydro-Québec.*[8]

In that judgment, the Supreme Court concluded that the doctrine of foreseeability (*hardship*), according to which a party can be required to renegotiate a contract should a sudden change in circumstances make the contract too onerous for the other party, is not recognized in Quebec civil law. The SCC held that a party’s insistence on adhering to the letter of the contract does not constitute a breach of its obligation of good faith unless such an insistence is unreasonable in the circumstances. Despite the cardinal importance of the requirements of good faith at all stages of the performance of a contract, the duty of cooperation does not go so far as to require one party to sacrifice its own interests for the benefit of the other party.

In short, the requirements of good faith will be of no help to a contractor or supplier who wants to renegotiate a lump-sum contract due to the increased costs of materials or labour, unless there are exceptional circumstances where the customer’s refusal to renegotiate the contract could be considered unreasonable or abusive.

II– LABOUR AND EQUIPMENT SHORTAGES

In principle, contractors are responsible for ensuring that they have sufficient resources to carry out the work described in the contract, including labour and materials. In normal times, contractors can make up for shortfalls in their own workforces by calling in subcontractors. But the current labour shortage, exacerbated by the aging of the workforce, is making the labour required to carry out the work increasingly unavailable.

Similarly, the work may be delayed because supply chain disruptions prevent the materials from arriving.

Some contractors will be tempted to claim that labour shortages and a lack of materials that were unforeseen when the contract was signed amount to force majeure beyond their control, meaning that they cannot be held liable for the resulting delays. The Quebec courts have rejected those arguments several times.

In *Dazé* c. *9324-1974 Québec inc.*[9] the plaintiff claimed damages for being forced to have the demolition work that the

defendant initially undertook completed by another contractor. The defendant argued that a labour shortage made it impossible for it to act. The Court held that the labour shortage could not be set up against the plaintiff and that the defendant had an obligation to complete the work.

In *Bodycote, essais de matériaux Canada inc.* c. *Fromagerie de l'Alpage inc.*[10] the defendant had hired the plaintiff to conduct microbiological tests of a new cheese production to detect the presence of certain bacteria so that it could comply with regulatory requirements. The defendant discovered that the plaintiff had not conducted one type of test prescribed by the regulatory standards. To justify this failure the plaintiff argued that this test was unnecessary and that, in any event, it could not have been performed due to a shortage of the required scientific equipment. The Court found that the lack of appropriate equipment did not excuse the plaintiff's failure to provide the services required by the contract, and that it was not a case of force majeure within the meaning of article 1470 C.C.Q. On the one hand, the plaintiff was not unfamiliar with the shortage of equipment, since that was part of its usual business. On the other hand, the evidence did not establish that the plaintiff could not have reasonably anticipated the shortage of equipment when the contract was made.

In *Feizollahi* c. *9313-8865 Québec inc. (Aménagement Soleil Plus)*[11] the plaintiff claimed damages resulting from poorly executed and incomplete landscaping work. The defendant argued that the delays in carrying out the work were due to circumstances beyond its control, related to the COVID-19 pandemic. More specifically, it argued that the delays were due to the unavailability of materials and labour and the dramatic increase in her sales. Even though the COVID-19 pandemic may have caused disruption, the Court found that diligent planning would have allowed the defendant to guard against unforeseeable events. Knowing that many owners were doing landscaping work during the summer of 2020, the defendant should not have waited until the last minute to order the materials and equipment needed for this project.

In short, it is generally admitted that it is the contractor's responsibility to ensure the availability of labour and equipment before undertaking to complete work within the contract deadlines. The contractor may be liable for any extra costs if this type of situation causes delays, unless the parties have specified in the contract that the contract deadlines are subject to the availability of labour and equipment when the work needs to be done. It does seem possible, however, that an exceptional and unforeseeable shortage could amount to force majeure in some circumstances.

We have not found any precedent confirming that a shortage of labour or equipment could be a "cause independent of the will of the contractor" within the meaning of clause CG 6.5.3.4 of the CCDC2 Stipulated Price Contract or other similar clauses contained in standard contracts published by the CCDC and CCA to justify an extension of the contract deadlines. While some jurists consider that this term should be construed in a manner similar to the concept of force majeure under common law,[12] others have concluded that it may allow the debtor to escape liability in circumstances that do not meet the definition of force majeure under article 1470 C.C.Q.[13] Nevertheless, it is logical to assume that such a defence will only be admitted in cases where the contractor can demonstrate that the unavailability of the labour or equipment needed to complete the work could not reasonably be foreseen when the contract was signed, and is the result of circumstances beyond his control rather than his negligence in planning the work.

CONCLUSION

While it is always necessary to consider all the circumstances of each case, contractors will generally have to assume the risks associated with price increases and shortages of the resources required to carry out the work in a lump-sum contract, unless the contract contains a stipulation to the contrary. Since it is not always possible to anticipate a lack of materials or labour when taking on a large project, such issues should be expressly factored into the contract to reduce the risk of litigation.

The courts are highly likely to have further opportunities to look more closely at these issues as they pertain to contracts of enterprise or for the supply of materials that were made just before or during the COVID-19 pandemic. It will be interesting to follow the case law on these issues over the next few years, as well as all the issues raised by the disruptions caused by the overheating of the construction sector; they are bound to redefine Quebec's construction law.

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1. Art. 2109 C.C.Q.

2. *Métal APS inc.* v. Ventilabec inc., 2022 QCCS 773, EYB 2022-435800, para. 28.

3. 2022 QCCS 773, EYB 2022-435800.

4. Jean-Louis BAUDOUIN, Pierre-Gabriel JOBIN and Nathalie VÉZINA, “Motifs légaux d’exonération” in *Les obligations*, 7th ed., 2013, para. 845, *La référence*, Montréal, Éditions Yvon Blais, EYB2013OBL128.

5. Jean-Louis BAUDOUIN, Pierre-Gabriel JOBIN and Nathalie VÉZINA, *Les obligations*, supra fn. 4, para. 846; Didier LLUELLES and Benoît MOORE, “L’impossibilité d’exécution” in *Droit des obligations*, 3rd ed., 2018, para. 2734, *La référence*, Montréal, Éditions Yvon Blais, EYB2018THM244.

6. *Québec Métal Recycled (FNF) inc.* v. *Transnat Express inc.*, EYB 2005-98179 (QCCS), para. 16.

7. *Caisse Desjardins de St-Paulin* v. *Bombardier inc.*, 2008 QCCS 3725, EYB 2008-146023, para. 273.

8. 2018 SCC 46, EYB 2018-303592. For a detailed analysis of the highlights of this landmark decision, please refer to our bulletin entitled “The Supreme Court of Canada Confirms that the Doctrine of Unforeseeability is Not Part of the Civil Law of Contracts in Québec”: <https://www.fasken.com/en/knowledge/2018/11/van-churchill-falls-labrador-corp-v-hydro-quebec>.

9. 2022 QCCQ 1362.

10. 2006 QCCS 2322, EYB 2006-104419, paras. 36 to 40.

11. 2022 QCCS 2648, EYB 2022-450379.

12. *Ensyn Technologies inc.* c. *IMTT Québec inc.*, 2022 QCCS 1898, EYB 2022-451090, para. 49; *Domtar Inc.* v. *Univar Canada Ltd*., 2011 BCSC 1776, para. 86.

13. *Canada Starch Co.* c. *Gill & Duffus (Canada) Ltd*., EYB 1990-57083 (QC CA),

para. 10.