

Five trends as construction begins towards carbon neutrality

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As we press towards carbon neutrality, currently targeted for 2050, there are five trends emerging in engineering, procurement and construction contracts in New Zealand and around the world. These trends affect all project participants - funders, project sponsors, developers/principals, contractors and others in the project supply chain.

1. Consenting to become increasingly challenging

We expect that projects will be subject to more legal challenge on environmental and sustainability grounds. We see this trend emerging overseas, for example in the United Kingdom through the challenge to the proposed expansion of Heathrow Airport - on the grounds that it is inconsistent with the United Kingdom's climate targets. We are also beginning to see this happen domestically through the Lawyers for Climate Action's challenge to the Auckland Regional Land Transport Plan on similar grounds. While we expect these challenges to be, at least initially, confined to the project consenting phase, as the climate situation worsens, there seems a real prospect that projects may remain subject to the threat of ongoing challenge.

In a contractual context, developers, contractors, and other members of the project supply chain will need to be alive to these risks and, we suggest, deal with them in their project documentation. The fundamental question is who is 'on-risk' for the time and cost consequences of delays relating to such challenges.

2. Extension of performance warranties and guarantees

We envisage funders, project sponsors and developers/principals requiring contractor warranties and guarantees extending beyond conventional performance and 'design-life' requirements, like defect-free operation, to include operational compliance with carbon neutral requirements. The practical effect of these requirements is likely to markedly increase the potential liability of contractors and designers – a risk that they will, without doubt, price into their tender response. Like any emerging regulatory requirement, this will likely result in a more complex and refined contractual treatment of liability allocation to failure to comply with environmental regulatory requirements together with variation mechanisms to respond appropriately to changes in law and client requirements during the design and construction stages.

On a similar, but more practical, point, we expect to see developers/principals placing more emphasis on buildings designed and developed in a way that supports multiple long-term tenancy options. This recognises that the construction of a new building has a significant carbon footprint and seeks to mitigate that footprint by optimising the longer-term use of the building. As a result, we expect to see developers/principals requiring, as part of their request for proposal process, that buildings be designed with ease of adaptability or retrofit in mind.

3. Requirements of funders, project sponsors and developers

Funders, sponsors and developers are already under ever-increasing public and regulatory scrutiny in relation to setting, and delivering against, environmental and sustainability requirements for projects. In addition, as part of their wider environmental, social and corporate governance objectives, public sector organisations and businesses (particularly listed companies) are increasingly setting their own targets. These requirements and targets will relate not only to the completed project but also to materials and methodologies used during construction, which must be then passed-down the project supply chain by funders, sponsors and developers.

Contractually, this will be achieved through the conventional mechanisms of design consultancy agreements and construction contracts. We also expect a role for 'third party agreement' provisions under which, for example, certain sustainability requirements of a funder, sponsor or developer are passed down to the main contractor, with the expectation that the main contractor will comply with these requirements as if they were a primary contractual counterparty. It is a natural extension that the contractors, and their subcontractors and suppliers, will be evaluated against a client's carbon-neutral requirements and targets as part of competitive tender processes.

At a practical level, we are already seeing innovation with construction materials and methods, such as:

- Processes such as off-site construction

- Emerging materials such as mass timber and carbon capture concrete and energy capture and storage tools, such as solar panelling or batteries
- Incentivisation of more efficient use of plant and machinery and transition from diesel fuelled plant and machinery
- Prioritisation of locally sourced equipment and labour
- Improved logistics and planning to minimise site deliveries
- Undertakings to formally offset of carbon emissions.

We are also aware of overseas funders and project sponsors using financial incentives for developers to deliver projects within certain pre-determined sustainability targets – for example, through a reduction in the cost of borrowing for the developer/principal.

4. Additional relief for extreme weather events

Similar to what has occurred recently with Covid-19 related matters, we expect that contracts will become more sophisticated in allocating risk for extreme weather events – given the frequency of extreme weather events is predicted to rise dramatically. We doubt that it will be a realistic 'solution' for clients to simply allocate the risk to the contractor and expect the contractor to price or insure against the risk.

5. Widening of 'applicable law' and provisions to explicitly respond to environmental and sustainability concerns

The increased focus on environmental and sustainability requirements and targets is likely to result in contractual performance frameworks customised to incentivising compliance and innovation in this area – as has occurred with workplace health and safety. Financial incentives and abatements could provide a basis for this contractual framework.

On this same point, we expect tendering developers/principals, contractors and other members of the project supply chain to have to demonstrate, at a granular level and as part of their tender response, that they are familiar with the applicable environmental and sustainability-based legislation.

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