Construction

Force Majeure Coverage Review:

COVID-19 related contractual considerations

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COVID-19 related contractual considerations for construction clients

Parties to construction projects are suddenly facing the prospect of significant delays and disruptions from the threat posed by COVID-19. While prior disruptive events involved singular impacts, the COVID-19 crisis involves interruption to supply chains, labor supplies and emerging financial impacts. Additional demand side shocks should be anticipated, such as homebuyers putting their plans on hold until times seem more certain, then coming back into the market with increased demand and unleashing a potential flood of activity.

As the last few weeks have shown, the only thing certain about COVID-19 is uncertainty—uncertainty about the disease, uncertainty about the efforts to combat the disease, and uncertainty about how it will affect the markets. In these rapidly evolving circumstances, contractors and owners should consult with their legal counsel and consider implementing new contract clauses addressing (a) direct COVID-19 impacts, (b) the impacts of existing and future government action to combat the pandemic, and (c) the possibility of an extreme rebound in activity.

With respect to existing contracts, all parties should be reviewing their contracts for relevant clauses and making sure they issue required notices. While it may seem counterintuitive, prime contractors should reach out to their subcontractors and suppliers to identify potential sources of delay to ensure they give the proper notices to their owners. Because the COVID-19 threat is fast-evolving and hitting different parts of the world at different times, contractors should require periodic updates from their subcontractors and suppliers. What is not impacted today could easily be impacted tomorrow as different areas go into lockdown or are otherwise affected by the virus.

Additionally, parties should be looking at possible sources of financing to overcome the impacts of this virus. Owners should review their financing agreements and land use authorizations to make sure they remain in compliance. If owners have relied on certificates of insurance for required coverages under their contracts, they should also be requesting copies of available coverages, especially Builder's Risk and CGL polices to see if some of the impacts could be covered. By the same token, contractors should be looking at owner-supplied policies on the project. Owners and contractors should also be looking to payment and performance bonds and subcontractor default insurance policies to address possible financial defaults. All parties should be talking to their bankers to make sure they have the liquidity available to get through anticipated delays and closures.

While each case is different, some of the key construction contract clauses to consider are:

1. Force Majeure and Delay Clauses.

"Force Majeure" is generally defined as an unforeseeable circumstance that prevents someone from fulfilling a contractual obligation. Most U.S.-based contract forms, such as the AIA, ConsensusDocs, and EJCDC forms include force majeure concepts in the Delay clause. Federal Acquisition Regulations ("FAR") and the ConsensusDocs and EJCDC forms expressly mention "epidemics" as an example of delay outside the control of the contractor. But even if epidemics are not specifically mentioned, the contractor is likely to be entitled to relief since the epidemic was "beyond the control" of that contractor.

Generally speaking, these clauses provide the contractor with an extension of the contract time for delays caused by forces outside the control of the contractor, but include no right to additional compensation. To obtain relief, the delay typically must be on the critical path of the contractor's work—i.e. it must cause an actual increase the duration of the work.

The contractor's right to relief is also dependent on the contract clauses related to notice and submission of claims. While courts may excuse minor defects in the notice provisions in private contracts so long as there was no prejudice, many state courts require strict compliance with state and local government contracts. Contractors making such claims on all government contracts should consult with their legal counsel and are encouraged to pay close attention to the False Claims Act in Federal Contracting and state equivalents when contracting with states and municipalities.

Although force majeure clauses generally limit relief to an extension of the contract time, the contractor may still become entitled to additional money. For example, if the owner refuses to grant an extension of the contract time, thereby requiring the contractor to accelerate its work, the contractor may assert a "constructive acceleration" claim. Additionally, there may be coverage for the costs under the Builder's Risk policy or other contract provisions. Again, specific situations should be discussed with legal counsel.

2. Escalation Clauses.

"Escalation Clauses" allow a contractor to receive an increase in its contract price if the costs go up under circumstances as described in the clause. Unit price provisions may contain exceptions allowing for an increase in the unit cost if changes in quantities would result in a hardship to the contractor or the owner. While most lump sum contracts do not require the owner to pay more just because the contractor's costs have increased, it may be beneficial for contractors to include such a clause, especially in the current environment.

If the contract is cost-reimbursable up to a Guaranteed Maximum Price (GMP), there is risk in a contractor agreeing to a GMP without including an escalation clause, qualification or exclusion that allows it to make a claim if costs increase beyond those on which the price is based. Alternatively, if the GMP has already been fixed, then the contractor may have savings or contingency it can use to absorb these costs.

3. Change in Law Clauses.

It is generally recommended that contractors negotiate a change-in-law clause because one never knows what the government may do over the course of a project. A sample clause may read, "Should any change in law affect the Contractor's cost or time of performance, it shall receive an adjustment

in the Contract Price and Time for performance caused by such change in law." Ideally, the contract definitions should provide a broad definition of law to include not just laws and regulations, but also acts of government officials having jurisdiction over the project. Even without such a broad definition and depending on the particular wording of the agreement, a national or state declaration of emergency for COVID-19 that impacts the project may be considered a change in law.

4. No Damages for Delay Clauses

Prime contracts and subcontracts may include a no-damages-for-delay clause that prevents the contractor or subcontractor from claiming damages for delay. These should be evaluated on a case-by-case basis.

In many states such clauses are unenforceable or subject to various exceptions. One of these exceptions is for delays that were outside the reasonable contemplation of the parties. If the Force Majeure or delay clause expressly identifies pandemics or epidemics as a delay outside the control of the contractor, it would appear that the parties may have contemplated delay from something like COVID-19. But the contractor may still be able to recover for delays caused by the declaration of a national emergency and resulting government action as being outside the contemplation of the parties.

Additionally, it is not uncommon for such clauses in subcontracts to allow the subcontractor to recover delay damages to the extent the contractor is able to recover them from the owner. It is important that subcontractors review the prime contract before submitting such a claim (so long as the subcontractor does not fall afoul of the subcontract notice requirements) and in order to fully understand the subcontractor's rights and obligations.

5. Mutual Waiver of Consequential Damages

Most prime contracts contain mutual waivers of consequential damages that include the owner's damages for loss of use. These tend to be viewed more as a shield.

6. Owner's Duty to provide adequate assurances of financing

Most form contracts require the owner to provide documentation that it has adequate financing to complete the project and include provisions allowing the contractor to request verifying documentation. Contractors may want to exercise this right if it appears that the owner's financing may be in jeopardy.

7. Termination and Suspension Provisions.

AIA General Conditions allow a contractor to terminate a contract if the work is stopped for a period of 30 consecutive days through no act or fault of the contractor, and these Conditions identify an act of government, such as a declaration of national emergency, as requiring all work to be stopped. While the current regulation (unless a shutdown is mandated) does not require all work to be stopped, conditions arising from infection by one worker of others on the project or limiting the work force may allow for suspension of the contract. The prospect of suspension and/or later termination can potentially be used to negotiate a mutually agreeable increase in the contract price to compensate the contractor.

8. Emergency and Safety Clauses.

Many form contracts, like ConsensusDocs, authorize the contractor to act in an emergency affecting the safety of persons or property, and to obtain compensation for the costs incurred. Likewise, safety clauses generally require the contractor to provide a safe and healthy workplace. Weekly subcontractor meetings and working in cramped places may prevent the sort of "social distancing" that prevents one worker from infecting another. Contractors may want to consider various ways of addressing this—for example, setting up large tents instead of using cramped trailers for subcontractor meetings or setting up separate sanitary facilities for each crew. Additional costs for this work may qualify for a claim under the emergencies clause based on federal and state declarations. As always, the contractor will need to give prompt notice of any such claim, but it is advisable to notify the owner of such actions and the contractor's expectation of payment before incurring these costs.

Conclusion and Best Practices.

All project participants should be prepared for potential claims arising from COVID-19. To prepare for these claims, we encourage you to consult with experienced legal counsel to review the relevant contracts and insurance policies.

As with everything on a construction project, prompt and clear communication is necessary both to preserve rights and to mitigate impacts on the project. Notices, especially on government work, must conform to all appropriate formalities, including the persons to whom the notices are addressed and the means of delivery. The notices should:

a) Explain how COVID-19 and government actions to slow its spread qualify as force majeure and entitle the contractor to relief under the contract.

b) Explain with appropriate specificity how the project is impacted, including references to specific materials delayed and activities affected. Contemporaneous documentation, such as photos, showing that the delayed material or work was on the critical path will make for a much more persuasive presentation.

c) Identify the potential impact in terms of time and money and the efforts the contractor is undertaking to mitigate those impacts.

As more information becomes known, these notices should be updated. Careful attention should be paid to contractual provisions regarding the contents and timing of claim submissions after the initial notices.