ALERTS AND UPDATES

Coronavirus and Construction Contracts

March 18, 2020

As you have undoubtedly heard, coronavirus disease 2019 (COVID-19) is affecting the global construction industry.

Notably, as of March 17, Boston halted all construction jobs in the city for two weeks due to the COVID-19 pandemic. This decision has affected approximately 21.4 million square feet of new or renovated development across 97 projects. Other municipalities have implemented travel restrictions and shelter-in-place orders requiring individuals to stay at home except as necessary to provide certain essential business and government services. These domestic actions, coupled with tighter border controls and quarantines at the international level, will inevitably result in supply chain disruption and labor force shortages.

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As COVID-19 continues to spread throughout the country, it will impact project performance. Below are some important contract considerations that parties should keep in mind as they evaluate their response to project delays and closures, safety concerns, and vendor and workforce unavailability.

Force Majeure

A force majeure clause in a construction contract sets forth the conditions under which one party is excused from performing. These conditions tend to have two predominant elements: that the condition was unforeseeable and that parties lacked control over the condition. A force majeure clause should be read carefully, as it will specifically identify what events excuse a party from performance.

Some force majeure clauses, such as Section 8.3.1 of the AIA A201-2017, General Conditions of the Contract for Construction, will refer generally to "causes beyond the Contractor's control" and "other causes that the Contractor asserts, and the Architect determines, justify delay." Others, such as 48 CFR 52.249-10, a Federal Acquisition Regulation (FAR) provision applicable to government contractors, may specifically mention "epidemics" and/or "quarantine restrictions." Still others will reference acts of governmental bodies that affect the supply or availability of labor or materials.

Contractors intending to rely on a force majeure clause in a construction contract to excuse timely performance as a result of COVID-19 must pay close attention to the notice provisions therein. Failure to notify a party of a force majeure event within the stated timeframe may waive that party's right to any extension of time to which they might otherwise be entitled. Moreover, contractors should be aware that some force majeure clauses require that the contractor demonstrate efforts to minimize the period of delay by commercially reasonable means, which in a situation involving the stalled import of materials from overseas may include finding alternate sources of the goods domestically.

In addition to seeking an extension of time for performance in the wake of COVID-19, contractors may try to recover additional compensation to offset the impact of the outbreak. However, many owner-friendly construction contracts provide that in the event of force majeure, the contractor is entitled solely to an extension of the contract time, and not to any additional compensation as a result of the force majeure event. For instance, owner-developers are often encouraged to include in their construction contracts language making clear that force majeure events and other contemplated delays cannot give rise to any claim for damages or other compensation in the form of an increase to the contract sum, although most sophisticated general contractors and construction managers will negotiate this point.

In New York, "no damage for delay" clauses are enforceable.[1] That said, courts narrowly construe these clauses. Despite the existence of a no-damage-for-delay clause in a construction contract, the courts will allow a contractor to recover delay damages if the contractor can prove that the delays fall within one of the following four exceptions:

1. Delays caused by the contractee's bad faith or willful, malicious or grossly negligent conduct;
2. Uncontemplated delays;
3. Delays so unreasonable that they constitute an intentional abandonment of the contract by the contractee; and

4. Delays resulting from the contractee's breach of a fundamental obligation of the contract. [2]

The contractor bears a heavy burden of proving that one of these exceptions applies.[3] In the context of COVID-19, the relevant question will be whether delays caused by the pandemic were contemplated at the time of contract execution. The case law on this point by and large focuses on the types of delays that are more typically encountered on construction projects, such as whether delays caused by changes, design errors or inept supervision were contemplated by the parties.

Here, parties will have to debate whether the current COVID-19 outbreak was foreseeable or could have been anticipated. Owner and developers, where they can, will point to specific provisions in their contracts that contemplate epidemics, pandemics, quarantines and delays arising from governmental acts to argue that none of the above exceptions apply. Contractors, on the other hand, will argue that the last large-scale quarantine in the United States took place during the Spanish flu epidemic of 1918 and that the current restrictions in effect could not have been anticipated at the time of contracting. Ultimately, whether a particular no-damage-for-delay clause is upheld in the wake of COVID-19 will depend on the specific contract language at issue, as well as the ripple effect of the containment measures, the full degree of which may not be known for weeks or months.

Suspension of Contract

Owners and developers should also look closely at the termination and suspension provisions in their construction contracts when considering their response to the COVID-19 outbreak. If uncertainty and changing circumstances on the ground make continuing with work impossible in the short term, a suspension clause may be a helpful tool in controlling cost and impact for a finite period of delay. This is particularly true when the contract requires the contractor to hold its price for the suspension period.

The parties can also consider if a temporary suspension of the project would allow them time to determine how to proceed with the project in a manner that is mutually acceptable. Owners should be aware, however, that many construction contracts provide that a suspension lasting longer than a specific duration may trigger the contractor's right to terminate the contract.

In the event of a project suspension, whether voluntary or by order of governmental authorities, the parties must make arrangements to secure the project site and heed all applicable safety requirements. Owners and contractors must ensure that the site is

adequately monitored throughout the closure and that the proper insurance remains in place. Careful consideration and discussion should also be given to what will happen when work resumes following such a suspension.

Insurance

Insurance policies, particularly commercial property policies, may help in offsetting the effects of a project shutdown. Many of these policies contain an endorsement for business interruption coverage. Policyholders should carefully read such endorsement to determine whether delays caused by COVID-19 constitute an "occurrence."

Loan Documents

Owners and developers must also look closely at any underlying loan documents on a project to determine what, if any, notice has to be given to a lender if the project being funded is delayed by COVID-19. Agreements between a lender and borrower will typically contain language requiring that the borrower notify the lender of any force majeure events that it anticipates will materially affect the required project completion date. Owners should be proactive in reviewing all covenants (including financial information and other deliverable requirements), notice requirements and other credit document provisions for potential breaches, and proactively seek to address the concerns of lenders before they become a crisis.

Conclusion

In conclusion, the COVID-19 outbreak continues to be a dynamic situation and the ultimate impact and timeline remain unknown at this juncture. As construction project participants navigate the novel issues it has raised, they should closely evaluate their construction contracts in order to make the best decisions regarding ongoing work and project safety, as well as to implement strategies to mitigate financial and schedule impacts as much as possible. To the extent parties can mutually agree to a resolution or workout plan now, jobs will proceed more smoothly when COVID-19 subsides.

About Duane Morris

Duane Morris has created a COVID-19 Strategy Team to help companies plan, respond to and address this fast-moving situation. Prior *Alerts* on the topic are available on the team's webpage.

For More Information

If you have any questions about this *Alert*, please contact Meghan DiPerna, Kenneth H. Lazaruk, Brian A. Shue, any of the attorneys in our Construction Group, members of the COVID-19 Strategy Team or the attorney in the firm with whom you are in regular contact.

Notes

[1] *Corinno Civetta Constr. Corp. v. City of New York, 67 N.Y. 2d 297, 309-10, 502 N.Y.S. 2d 681, 685-86 (1986)*

[2] *Corinno Civetta*, 67 N.Y. 2d at 309, 502 N.Y.S. 2d at 686

[3] *Dart Mechanical Corp. v. City of New York, 68 A.D.3d 664, 891 N.Y.S. 2d 76, 77 (1st Dep't 2009)*