

Proceed, Pause or Be Damned? Immediate Construction Contract Considerations for Owners and Contractors

Article

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COVID-19 is causing many of us to alter expectations. Many in the construction industry are confronting this reality and need to prepare for the potential legal implications.

Construction businesses are looking at three significant, interrelated issues from virus' impact: labor (having healthy, able workers available in the time of social distancing and keeping them safe); project delays; and cash flow. To the extent projects can be completed and paid, then great. But as worker and material availability are reduced, delays follow, and money can become tight. Owners and contractors should prepare.

Review your Contract for Risk...

Not all construction contracts will have identical language, but common provisions in standard forms can be instructive. If you are a contractor and your workers, or those of your subcontractors, are unable to work on site because of social distancing or quarantining, causing the project to slow or halt, the project may be delayed. Does the contract set a deadline? If yes, what is the risk of not meeting it? Often times, the answer is liquidated damages, and if so, determine how much are they, when they commence, and whether they are capped. Alternatively, the contract may permit consequential damages, if for instance, the owner cannot open on time and operations do not start. Is there exposure under that potential risk? Or is the owner otherwise delayed due to the impact of COVID-19, and construction delays arguably have no impact?

Additionally, the contract may allow an owner to terminate for cause. AIA § 14.2 provides that the failure to supply enough skilled workers is a justifiable basis. AIA §§ 2.3 & 2.4 would further permit an owner to stop work and potentially replace the contractor to complete the project. Is the terminated contractor responsible for any cost overruns?

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The risks of delay or termination can be financially devastating. So of course a contractor could press on with the work, bringing in crews to get the project done. But what if that decision causes an outbreak of virus on a site where, let's say, the owner has active operations? Suppose further the contract contains this common indemnification language:

- 3.18 INDEMNIFICATION
- 3.18.1 To the fullest extent permitted by law the **Contractor shall indemnify, defend and hold harmless the Owner** its elected and appointed officials, officers, employees, and authorized representatives the Architect, and Architect Consultants from and **against suits, actions, claims, loss**, legal or administrative proceedings, liabilities, costs, expenses, damage or injury, including reasonable attorneys' fees, arising out of or resulting from performance of the Work, provided that such claim, damage, loss or expense is **attributable to bodily injury, sickness, disease or death**, or to injury or destruction of tangible property (other than the Work itself), but only to the extent caused, in whole in part, by the negligent acts or omissions of the Contractor, a Subcontractor, anyone directly or indirectly employee by them or anyone whose acts they may be liable, regardless of whether or not such claim, damage, loss or expense is caused in part by a party indemnified hereunder. Such obligation shall not be construed to negate, abridge, or reduce other rights to obligations of indemnity that would otherwise exist as to a party or person described in this Section 3.18.

A contractor could be taking the risk of a significant loss for personal health and business interruption if its construction operations bring the virus onto the work site and a resulting outbreak is tracked back to that decision.

...And Relief

Not surprisingly, you can't just not continue with your project, and perhaps you likely shouldn't simply plow forward as is either. However, sometimes circumstances beyond your control entirely inhibit a project's ability to proceed. Hopefully, the contract provides alternatives if not answers.

Review your contract for a *force majeure* clause. Its basics are reviewed in detail in our related article linked here but in short, it can provide relief for a delay beyond the contractor's control. In AIA § 8.3, such a delay "shall" give rise to a change order for a "reasonable time." However, these provisions can be limited to only a time extension. There might be no adjustment in the contract price, even, for example, if the increase in the schedule also means an increase in the general condition costs. This can prove very costly. Be sure to parse the language carefully.

If there is an increase in the project's cost due to the impact of COVID-19, then a contractor may need to invoke the change procedure to obtain approval and a price adjustment. The change order process should put the decision to increase

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the project price in the hands of the non-paying architect rather than the would-be-paying-owner. Again, review the language and requirements carefully. There is almost certainly going to be written notice requirements – both a time period in which to advise of a potential claim and possibly a list to whom this notice is to be given. Perhaps defects in notice can be overcome, but eliminate the question mark by following the requirements.

Owner Rights

Contractors are not the only ones facing risks. Owners now have changed expectations to their cash flow or financing also. Typically, the construction contract will give them some options. AIA Article 14, for example, allows owners to either suspend or even terminate the contract for convenience. Under our current circumstances, a suspension could have appeal to both sides. Often, the language allows for both a time and cost extension to the contractor, but holds the work until the time is right for the owner. This may be a conversation worth having.

As always, and with any issue on any project, the more you can communicate with each other, and the clearer all issues and decisions are documented, the better.

Forced Shutdown

For now, the above issues are between owner and contractor. The government, however, could change things significantly. If a mandatory shelter-in-place order is issued – like in California and Illinois – such an order would take a key decision – whether to continue for now – out of the hands of the parties. Parties should note relevant contractual language, like that mandating “compliance with all governmental laws, statutes, ordinances, codes, rules, regulations, and orders” or words to that effect. This would provide contractors with good cause to cease operations. Then what? As noted above, cooperative parties might agree to suspend, contractors with a force majeure provisions can invoke what relief is provided, and owners can reassess whether the project should survive. Unfortunately, the construction world is up in the air, and results will vary based on the scope of any government intervention, the particulars of a different contract, and everyone’s reasonable expectation adjustments.

A final note any time a business – owner or contractor – is confronted with risk, it should evaluate whether it has protected against that risk outside the contract itself. For instance, business interruption insurance is often triggered when other “natural disasters” impact the industry. If losses prove inevitable, carefully assess whether they are covered losses under one or more applicable insurance policy.

With careful consideration, parties can get through these difficult times and continue forward successfully.

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*Author's Note: Gov. Evers' March 25th "Safer At Home" Order exempted most construction activity as "**Essential Infrastructure**" encompassing either "Essential Business and Operations" or "Essential Government Functions". Only "optional or aesthetic construction" is to be avoided, per the order. Building and Construction Tradesmen and Tradeswomen are also included among the list of exempted personnel who are permitted to continue operations to provide these Essential Infrastructure needs.*

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