

Assessing COVID-19 Remedies Under Construction Contracts

By **Jonathan Pray and Kevin Walsh** (March 18, 2020)

As those in the construction industry grapple with the practical and legal effects of the global COVID-19 pandemic, attention has primarily been focused on who is responsible for anticipated delays to construction projects. This focus is appropriate because there is a substantial likelihood that ongoing and future construction projects will experience delays caused by the coronavirus.

These delays could manifest in any number of shapes and sizes, including, potentially: the orders of public officials; the closure of government agencies or offices; shortages or unavailability of construction materials, supplies or equipment; or shortages or unavailability of labor.

For the most part, allocation of responsibility for delays will depend upon the language of the construction contract, including so-called force majeure or remedy-for-delay clauses. In some instances, the common law definition of “impossibility” or “impracticability” of performance may also relieve a party from its obligation to perform.

Aside from project delays, however, the coronavirus pandemic implicates numerous other rights and remedies between the parties to an owner-contractor agreement. A familiar framework for analyzing these rights and remedies is the standard form the American Institute of Architects' Document A201 — 2017 General Conditions of the Contract for Construction.

The A201 is widely used and recognized, and contains allocations of risks that are similar to other standard-form contracts in the construction industry. The following sections from the A201 are particularly applicable to the current coronavirus pandemic:

Evidence of the Owner's Financial Arrangements

Under Section 2.2 of the A201, there are generally two points in time when the owner may be required to provide to the contractor reasonable evidence that the owner has made financial arrangements to fulfill the owner's obligations under the contract: first, prior to commencement of the work and upon written request by the contractor; and second, following commencement of the work, but only under certain, enumerated conditions.

One of those conditions is if “the Contractor identifies in writing a reasonable concern regarding the Owner's ability to make payments when due.”

Given the recent downward trends in the stock market and the broader economy, much of which has been attributed to the coronavirus pandemic, the contractor would be well-advised to request assurances of the owner's ability to pay for the costs of construction as they become due (whether prior to commencement of the work or after).

This is especially true where the owner is financing the project through construction loans, and those loans are predicated upon either personal guarantees or certain assumptions about the borrower's net worth or credit worthiness.



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As a result of the recent downturn, it is possible that the borrower is now unable to satisfy the requirements of the loan agreement, which may have the effect of putting the loan in default or out of balance and thus prevent the flow of draw requests to fund construction.

Failure to request such assurance could leave the contractor in the precarious position of having funded significant portions of the work at its own cost and credit, only to find that the owner is unable to obtain funds from the lender, and thus unable to reimburse the contractor for work performed for an indefinite time.

If, on the other hand, the contractor becomes aware of problems with the owner's financing through this request, then under the A201, it is entitled to immediately stop performing the work, to obtain an extension of the contract time for the stoppage period, and to increase the contract sum by the amount of the contractor's reasonable costs of shutdown, delay and startup, plus interest.

Labor and Materials

The contractor is obligated under Section 3.4 of the A201 to "provide and pay for labor, materials, equipment, tools, construction equipment and machinery, water, heat, utilities, transportation, and other facilities and services necessary for proper execution and completion of the [w]ork, whether temporary or permanent and whether or not incorporated or to be incorporated in the [w]ork."

Moreover, except for minor changes in the work, the contractor may make substitutions only with the consent of the owner, after evaluation by the architect.

Among other impacts, the coronavirus pandemic has disrupted supply chains and has caused the closure of factories, which may result in shortages or unavailability of construction materials necessary for the proper execution of the work.

In anticipation of this occurrence, contractors should begin to regularly examine the availability of materials specified by the contract documents, as well as the availability of materials, equipment, tools and machinery that are intended to be used by the contractor as part of its means-and-methods of construction.

Where the contractor's compensation is subject to a guaranteed maximum price, or GMP, the owner is generally under no obligation to approve change orders for the increased costs of obtaining materials specified in the contract documents. Therefore, contractors should begin developing contingency plans in the event that materials, equipment or tools become limited or unavailable during the pandemic, including identifying alternative suppliers and substitute products.

At the same time, owners may need to reevaluate their priorities when it comes to completing the project on time, on brand, or on budget. Most likely, the unavailability of specified materials due to the coronavirus pandemic will entitle the contractor to an extension of time under Section 8.3.1 of the A201, for a reasonable duration until the specific materials can be procured.

Thus, if an owner's priority is completing the project by a certain time, the owner may need to be more flexible than usual in terms of approving substitutes of inferior quality, or paying extra for substitutes of superior quality, in order to maintain the project schedule. If owners are overly rigid in terms of their approval of substitutions of materials specified for the project, it is likely that the schedule will suffer and the contractor will not be held

responsible for these delays.

In addition to the scarcity of materials, the coronavirus pandemic has the potential to result in shortages or reduced availability of supervisory staff, laborers and skilled workers (who are already in short supply), all of whom the contractor is required by the A201 to provide.

Like materials, contractors should begin considering alternative sources of labor and workers, both on their own staffs and at the subcontractor level, in the event that key individuals are quarantined, hospitalized or otherwise unable to perform their duties when expected.

Under a GMP contract, the contractor will likely bear the financial impact of having to pay extra costs for supervisory staff, laborers or skilled workers because increased labor costs do not constitute a change in the work for which the contractor is entitled to additional compensation.

That said, the owner does have the option to procure and pay for supplemental labor, assuming it is available in the market, to maintain the project schedule. Those extra costs may be recoverable against the contract under Section 2.5 of the A201, but only if the owner can successfully show that the contractor's actions constitute a default or neglect to carry out the work in accordance with the contract documents.

Finally, from the owner's perspective, now is a particularly attractive time to secure payment and performance bonds for construction projects. These legal instruments shift the risks of the contractor's failure or inability to perform under the contract from the owner to the surety.

Because these risks are not typically covered by insurance (with the exception of subcontractor default insurance), performance and payment bonds are one of the most valuable assets available to owners to guard against the risks of labor/material unavailability and contractor insolvency, respectively.

Owners frequently balk at the cost of surety bonds (roughly 1% of the contract price), but with the arrival of the coronavirus pandemic, surety bonds may represent a form of legal protection that owners cannot afford not to have. In order to successfully shift these risks to the surety, owners must strictly comply with the notice and other requirements in the bond, including providing prompt notice to the principal and the surety after a default.

Changes in the Work

The sections within Article 7 of the A201 describe the circumstances under which a contractor is entitled to an adjustment in the contract sum, an extension of the contract time or both. As a general matter, contractors under a GMP contract are only entitled to an adjustment of the contract sum under the A201 for either: (1) changes in the work not reasonably inferable from the design intent expressed in the contract documents; and (2) damages for delay incurred by the contractor during a compensable period of delay.

Under the first of these options, with one exception, it is difficult to envision a scenario where the contractor would be entitled to extra money due to the coronavirus pandemic. The exception is the scenario discussed above, in which an owner willingly changes the work (such as by approving a superior product that is more expensive) in order to maintain the project schedule.

Under the second of these options, a delay caused by the coronavirus is likely not a compensable delay. While the contractor would presumably be entitled to an extension of time, it is likely not entitled to an increase in the contract sum, unless the A201 has been modified to allow for such an increase.

Therefore, as a practical matter, contractors under a GMP contract are unlikely to receive an adjustment to the contract sum for impacts caused by the coronavirus pandemic.

Given the heightened risk that the coronavirus poses to contractors operating under a GMP contract, such contractors should negotiate other economic protections into their construction contracts, including an increased fee, increased general conditions, or contingency amounts that the contractor is specifically permitted to use for coronavirus-related costs or delays.

Protection of Persons and Property

Article 10 of the A201 sets out the contractor's responsibilities for implementing precautions and programs for the safety of persons and property. These obligations include initiating, maintaining and supervising all safety precautions and programs in connection with the performance of the contract, as well as complying with applicable laws, statutes, ordinances, codes, rules and regulations, and lawful orders of public authorities, bearing on safety of persons or property or their protection from damage, injury or loss.

When it comes to safety, construction professionals typically tend to think about all of the dangers inherent to a busy construction site, such as heavy objects, floor penetrations, tie-offs and protective gear. However, the contractor's obligation for site safety arguably extends to implementing precautions and programs needed to keep employees and workers safe from the coronavirus pandemic, such as social distancing, limiting group sizes and interactions, staggering work hours, testing employees and mandatory quarantine procedures, all in compliance with privacy and health care laws.

These precautions and programs must also comply with any orders of public authorities. For example, a government-imposed limit on the size of public gatherings likely applies to the number of individuals working on a construction site. Because the response to the coronavirus pandemic is fluid, contractors are encouraged to stay regularly informed of proclamations by local authorities to ensure they are compliant

Emergencies

Section 10.4 of the A201 provides that, in an emergency affecting safety of persons or property, the contractor shall act, at the contractor's discretion, to prevent threatened damage, injury or loss. Additional compensation or extension of time may be available to the contractor for such an emergency. Whether the coronavirus pandemic qualifies as an emergency under this section has not yet been litigated.

That said, it is fairly safe to assume that this provision is reserved for emergent circumstances of a more temporally limited nature.

Because the coronavirus pandemic has already been declared and is expected to last for months, the pandemic itself likely does not qualify as an emergency for which the contractor could seek extra compensation from the owner. However, isolated events or circumstances of an emergent nature resulting from the pandemic could qualify, depending upon the circumstances.

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