LAMSON DUGAN & MURRAY LLP
ATTORNEYS AT LAW

CONSTRUCTION CONTRACTS AFTER COVID

INTRODUCTION

From staffing shortages to supply chain disruption, the pandemic wreaked havoc on the construction industry. During this presentation, we will discuss the changes that the pandemic has brought to construction contracts, with a focus on incorporating contract clauses to protect your client's profitability.

01

FORCE MAJEURE

Effect of Force Majeure Clause

Force majeure clauses seek to excuse the nonperformance of a party. A party is no longer obligated to perform when an event expressed in the force majeure clause occurs, and that event is the cause of the party's inability to perform.

Requirements for Force Majeure Enforcement

Contract Language: The first step in excusing nonperformance is to express the event in language of the clause. It is common to include events like "acts of God" or "causes beyond reasonable control." Since courts typically interpret these clauses narrowly, "acts of God" may not be interpreted to include the COVID-19 pandemic. The rule of thumb is the more specific the better. Having a list of specific events in a force majeure clause increases the clause's scope and leaves less room for interpretation.

Best practice is to include actual risks to your business and include catch-all language like "events outside reasonable control, including, without limitation" before your list of events.

Here is a sample clause:

> *Neither Party will be liable for any failure or delay in performing an obligation under this Agreement that is due to any of the following causes (which causes are hereinafter referred to as "Force Majeure"), to the extent beyond its reasonable control: acts of God, accident, riots, war, terrorist act, epidemic, pandemic (including the Covid-19 pandemic), quarantine, civil commotion, breakdown of communication facilities, breakdown of web host, breakdown of internet service provider, natural catastrophes, governmental acts or omissions, changes in laws or regulations, national strikes, fire, explosion, or generalized lack of availability of raw materials or energy.*
>
> *For the avoidance of doubt, Force Majeure shall not include (a) financial distress nor the inability of either party to make a profit or avoid a financial loss, (b) changes in market prices or conditions, or (c) a party's financial inability to perform its obligations hereunder.*

02

ESCALATION

Price Escalation Opportunities for Existing Contracts

The good news is that more contracts are including escalation clauses. For example, Consensus Docs 200.1, allows the parties to establish a baseline price for specified volatile materials. If the price of the identified materials changes, the parties are entitled to an increase or decrease in the contract sum. Consensus Docs also offers an "Amendment No.1", which provides for price adjustments on essential materials if a project is experiencing or is expected to experience significant, industry-wide economic fluctuation during the performance of the agreement.

You should also look at the timing of the contract and if it has been substantially delayed, there may be contract provisions that allow for adjustments to the contract sum.

If you are subject to a homegrown contract, such as those created by the large construction companies, you are well advised to review them very closely to see if there are any opportunities to provide notice of a change in circumstance and demand an adjustment of the contract sum.

Addressing Price Escalation on Future Projects

Going forward, price escalation should be considered early on in every project—from the bid to the contract.

When preparing bids, those materials that may be subject to price swings should be identified and discussed with the upstream contractor or owner. Be very careful about signing bidding requirements that place the risk of all price increases on the bidder. Instead, demand a price escalation clause be added to the bid to reflect your concerns. If the upstream contractor refuses to accept an escalation clause, you may seek to include an increased allowance or larger contingency to account for any price increases. Finally, you may want to shorten the time frame your bid is open for acceptance.

02

ESCALATION CONTINUED

Once you get past the bidding process, make sure your price escalation concerns are addressed in the contract. General contractors should be advocating for price escalation clauses in the contract with the owner, and similar clauses should be included in subcontracts. You can also propose that language be added to the construction contract. A typical escalation clause provides:

If, during the performance of this contract, the price of _____significantly increases, through no fault of contractor, the contract sum shall be equitably adjusted by an amount reasonably necessary to cover any such significant price increases. As used herein, a significant price increase shall mean any increase in price exceeding ____% from the date of contract signing. Such price increases shall be documented through quotes, invoices, or receipts. Where the delivery of _____ is delayed, through no fault of contractor, as a result of shortage or unavailability, contractor shall not be liable for any additional costs or damages associated with such delay(s).

03 MATERIAL AVAILABILITY

It is not uncommon for materials to become sparse as a construction project gathers speed. Addressing this situation early on is critical. Construction contracts should be addressing some, if not all, of the following options:

- Purchasing Early. Can a contractor purchase materials early in the project, even if they will not be installed for some time?
    - Can the contractor turn in a pay-app for the materials early in the project?
    - Who pays for storage?
    - Who bears the risk of loss for the materials?
- If the owner refuses to allow early purchase, will the owner take on the responsibility for buying the materials when they are needed?
- Can the parties discuss and agree on substitute materials should the original materials become unavailable?

04 EXCUSABLE DELAYS

Every construction project suffers delays. And every construction contractor should be addressing his or her rights to additional time and/or compensation due to excusable delay.

But, what's the difference between excusable and non-excusable delays? An excusable delay is an event that the contractor is not able to control, while a non-excusable delay is something for which a contractor has assumed the risk of happening. An excusable delay is usually something that no one expected would happen, like COVID or a polar vortex. It may also include defective designs, design changes, and interference from the owner.

What does your contract say about excusable delays? Most contracts, especially those from large general contractors, allow a contractor more time to complete the project when an excusable delay impacts the project. These same contracts often indicate that a contractor will be entitled to additional time, but no additional compensation.

Here are some questions to consider when you are reviewing an excusable delay provision in your construction contract:

- Is there a limit on the delay?
- How long can you be required to wait to complete the project without getting additional compensation?
- If the project is delayed beyond the time limit, are you entitled to rebid unfinished portions of the work?
- Can you recover an increase in material or fuel costs?
- Can you recover demobilization and remobilization costs?

05

COVID-19 IMPACT

As contractors continue to deal with the impact of COVID-19, it's important to address the problems that COVID has caused and look to the future to avoid them on upcoming projects. The largest concern is the impact that complying with COVID procedures may have on the project. If employees must be tested regularly, and wait for the test results, productivity may be impacted. If employees must physically distance, this too can impact productivity.

Perhaps you should consider clauses in your contracts that will provide relief if specific measures are implemented that will impact your productivity. Here is an example:

> *Notwithstanding the requirements and obligations set forth in the Contract Documents and this Agreement, Contractor shall be entitled to an extension of the Contract Time and an equitable adjustment of the Contract Price, due to labor shortages, material escalation, or otherwise, for the performance of Subcontractor's Work due to events and conditions beyond Contractor's control, including the present impacts from the Coronavirus pandemic. Contractor will employ efforts to mitigate such delays and increased costs, in consultation with Owner, and will provide regular updates to Owner as to any time or cost impacts resulting from this provision. Disputes as to the entitlement of extensions of Contract Time or increases in the Contract Price shall be resolved pursuant to the Dispute Resolution provisions of this Agreement.*

06

INDEMNITY

Most construction contracts contain indemnity clauses, and owners and general contractors are loath to limit their application. Here is a pretty typical indemnity clause:

> *GENERAL LIABILITY INDEMNIFICATION*
> *To the fullest extent permitted by law the Subcontractor shall defend, indemnify and hold harmless upstream contractor from and against claims arising out of or resulting from performance of the Subcontractor's Work, provided that such claim, demand, damage, loss, cost or expense is attributable to bodily injury, sickness, disease or death, or to injury to or destruction of tangible property (other than the Work itself) but only to the extent caused in whole or in part by the negligent acts or omissions of the Subcontractor.*

Here are some things to consider:

- Is COVID-19 the type of “sickness” contemplated by this clause?
- If your employees infect others on the worksite, are you now responsible for even greater indemnity obligations?
- Is compliance with a COVID workplace policy enough to limit your liability?
- At what point does it become negligence to allow workers suspected of COVID-19 to continue to work?
- Do any other provisions of the contract allow you to limit your liability?
- Can you terminate the contract and avoid liability?

07 LIMITS OF LIABILITY

Is there anything you can do to limit your liability? Parties to a contract are typically liable for all losses that either arise naturally from their breach or are reasonably foreseeable at the time of entering the contract as a probable result of the breach. Under this rule of law, the party's potential liability includes both direct and consequential losses caused by its breach of the contract. Because the damages resulting from a large construction project can be so significant, parties oftentimes seek to quantify/limit their liability to each other.

Of course, a complete waiver of consequential damages would be preferred, but that may not be achievable. A compromise may be to limit recovery of consequential damages to the amount of available insurance. For example:

> *The parties agree to limit their right to recover consequential damages against the other party to consequential damages that are covered under any insurance policy procured by owner or contractor applicable to the work or applicable to the parties' obligation under the contract documents.*

08 FLOW DOWN CLAUSES

Flow down clauses, sometimes referred to as incorporation by reference clauses, pass through the obligations of the upstream contractor to the downstream contractor. The upstream contract may also require flow language in each subsequent subcontract. The goal of these provisions is to bind the subcontractor to the owner in the same way the prime or general contractor is bound to the owner.

A flow down clause can create any number of problems, primarily that no one requests the upstream contract and thus has no idea as to their obligations to the owner. Flow down clauses can also create conflicts with the subcontract.

To avoid the conflict situation, include a clause like:

> *Contractor and subcontractor agree that in the event of a conflict between the terms of this subcontract and the terms of the incorporated owner- contractor agreement the terms of this subcontract shall govern and control.*

When a subcontractor seeks to avoid language in the contract between the owner and upstream contractor, and has the ability to negotiate around some of the flow down, a clause to consider could be:

> *Notwithstanding any conflicting terms incorporated herein by reference to the contract documents, subcontractor does not agree to be bound by [insert excluded provisions, such as contractor's dispute resolution obligations with the owner, waiver of delay damages for delays or interference caused by others, waiver of lean and bond rights, performing its work in accordance with any standard other than as shown within the contract documents].*

09

TERMINATION

Given all of the problems associated with construction projects, it is often best to include a termination provision that allows your client to terminate the contract should certain events occur. These events may include escalation of material costs, delay of the project, shortage of labor, and the like – and there may even be a termination for convenience clause. The goal is to provide consistency throughout the contract chain and avoid one party being able to terminate for convenience, but downstream parties can only be terminated for cause.

Typically, only the owner can terminate for convenience. If you are drafting a termination for convenience clause for the owner, make sure to limit the general contractor's ability to recover profit on work not performed. A typical clause would include:

> *Contractor should not be entitled to and expressly waives any profit or fee on work not performed.*

Additionally, it may be beneficial to avoid subsequent review by a court or arbitration panel as to whether a contract was terminated for convenience or for cause by inserting language that the right to terminate for cause is in the sole discretion of the owner. For example:

> *Notwithstanding anything else contained in the contract documents, owner shall have the right at its sole and absolute discretion to terminate the agreement without cause and solely for the owner's convenience by giving the contractor written notice that the agreement is terminated.*

09

TERMINATION CONTINUED

An owner may also want to include language that a wrongful default termination may be converted to a termination for convenience. For example:

If, after a default termination, it is determined that the contractor was not in default, the rights and obligations of the parties will be the same as if the termination had been issued for the convenience of the owner. The owner shall then be liable to the contractor for any payments required by the termination for convenience clause.

If an owner insists on having a termination for convenience clause, contractors should strive to clarify the extent of recoverable termination costs. For example:

Contractor shall, within 30 days of receiving notice of termination, submit to the owner its statement of costs incurred and the performance of work terminated. Contractor waives any cost not included in such statement. Owner shall within 90 days pay to contractor all amounts it determines are properly included. Costs incurred by contractor shall include the following:

- *subcontractor termination costs;*
- *cancellation fees relating to equipment and material ordered;*
- *cost of all material and equipment ordered which cannot be cancelled;*
- *restocking fees incurred in returning ordered materials;*
- *Field work accomplished;*
- *permit, engineering, bond, and inspection fees; and*
- *attorney fees and expenses incurred terminating subcontracts and purchase orders.*

If the opportunity presents, try to get overhead and lost profit.

- *Subcontractor will be paid profit on the work not performed based upon percent complete as set forth in the pay applications.*

ABOUT LDM

LAMSON DUGAN & MURRAY LLP (LDM) was established on simple principles: hard work, integrity, and excellence in our practice. Today, our team includes over 40 attorneys who remain committed to those principles. We continue to expand our litigation and corporate expertise, while providing the highest level of service to our clients. Our locations in Omaha and Lincoln, Nebraska and Des Moines, Iowa enable us to proudly and effectively serve our region.

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