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LITIGATION

Infecting and Dissecting Construction Contracts

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Coronavirus is officially a pandemic — which, in the realm of infectious diseases, is the worst case scenario. Countries, cities, and schools are shuttering; sports are being played in empty stadiums or not being played at all; businesses and governments are encouraging employees to work remotely and forbidding some flights. For office workers, working remotely is a possibility. For the vast majority of people involved in construction operations, however, working at home is simply not an option. As people scramble to stay safe, construction projects could suffer major delays, disruptions, and damages.

The effects of COVID-19 may impact all players in the project — owners, contractors, subcontractors, suppliers, architects, consultants, sureties, and insurers. Below are four tips for proactively planning for and addressing potential risks and impacts caused by the infectious disease.

1. **Who bears the risk of loss? Read the Full Contract.**

In most states, including the four states our firm practices in — Texas, Oklahoma, Arkansas, and Florida — the starting point is to read the contract. The allocation of extraordinary risks — which may or may not include a pandemic — is generally a creature of contract. Courts typically look to the parties' contract to determine (a) if the parties addressed "acts of God" or *force majeure*; (b) any specific triggering events listed; and (c) the parameters and consequences of any contractual risk allocation.

The general rule is "an act of God does not relieve the parties of their obligations unless the parties expressly provide otherwise." *GT & MC v. Texas City Refining*, 822 S.W.2d 252, 259 (Tex. App. – Houston [1st. Dist.] 1991). In other words, if the contract does not address extraordinary perils, then the party with the duty to perform is usually still on the hook to perform.

If the contract does discuss natural hazards, courts will look to the terms to determine what is covered. Some contracts broadly include "any events outside of the control of the contractor." Sometimes "control" is qualified as "reasonable control." Other contracts enumerate the types of events covered — such as war, hurricanes, and floods. There are pros and cons with each approach. Neither approach is inherently better than the other. What constitutes a hurricane is relatively simple. What constitutes an "act of God" or "an event outside of the parties' reasonable control" can be trickier. Parties can minimize the chances of disputes via clear drafting, plain English definitions, openly communicating during construction, and maintaining a good working relationship towards the common goal of safely completing the project.

Even if an extraordinary event does occur, courts will not assume that delays contemporaneous with the event were caused by it. It is therefore important to keep thorough documentation and regular written communication to establish the link between the event and any resulting loss, damage, or delay.

Coronavirus may be an especially complicated case where the connection between the disease and the damage is *indirect* or *attenuated*. Unlike the visible destruction caused by a Florida hurricane or a Texas tornado, the impacts of Coronavirus can be more subtle, invisible, and remote.

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For example, if you are a Dallas-based steel subcontractor who sources steel from Italy, the suspension of commercial activity in the country may cause many months of production delay, which may be exacerbated by reduced or closed shipping channels, both of which could cause a domino effect delay on other trades, and consequential damages to the owner such as losing out on potential profits. Whether you can get an extension of time or whether you owe another party damages depends on the terms of the contract, may depend on whether the work causes delay to the critical path or whether float is available for your use, and may also depend on the specifications. Is "Italian steel" mandated by the specifications, or is buying from Italy just your ordinary business practice? In the former instance, you may have a valid excuse, but you will likely only be entitled to an extension of time. In the latter scenario, you may want to start looking for another country to purchase from. As discussed below, another issue may depend on the "primary purpose" of your contract.

2. Consider impossibility, impracticability, or frustration of purpose.

Three other potential issues are: (i) the doctrine of impossibility of performance; (ii) the UCC excuse of commercial impracticability; and (iii) frustration of purpose. Whether these apply and the repercussions of each could fill a treatise, so we will settle for a quick overview.

We start with the general rule that a party must perform its contract. These are potential exceptions that could excuse a failure to perform. Courts do not uniformly or neatly apply these exceptions, so it is important to analyze the history and application of each in your state. These doctrines should be viewed as a last resort, only after attempting to resolve any issues without the need for costly and time-intensive court intervention.

In the United States, *force majeure* continues to occupy a blurry position with the doctrines of impossibility, impracticability, and frustration. There are distinctions and some degrees of potential overlap. These doctrines might relieve a party's duty to perform, and might excuse or reduce liability. These doctrines can often be avoided by contractually allocating the risk (unless a state statute or court precedent forbids such allocation).

"Impossibility" is very rare. It might come in to the discussion if the disease causes the government to physically prohibit the construction. For example, if the city of Miami made the drastic decision to order destruction of The American Airlines Arena along Biscayne Bay, then a project to expand the arena would be impossible (there would no longer be any building to expand).

"Impracticability" also only applies in extreme cases, and only if the primary purpose of the contract is the sale of goods. It could potentially apply if performance is unfeasibly difficult or costly to perform, and if the party did not expressly or impliedly assume the risk of impracticability. If the Italian Steel Supplier only purchased and delivered the goods (and someone else was responsible for installation), and if the specifications called for steel from Italy, then "commercial impracticability" is a doctrine to consider. Determining the "primary purpose" is done on a case-by-case basis — a difficult case might occur where half of the subcontract price is for the timely delivery of materials and the other half is for installation. Impracticability is difficult to prove: it requires a drastic unforeseen change in circumstances and performance of the sale of goods to be economically senseless.

"Frustration of Purpose" is closely akin to impracticability, but there is an important distinction with regard to the event that triggers its application: instead of focusing on supervening events imped performance, the frustration doctrine focuses on supervening events that would make the exchange *worthless* to one of the parties. Different courts and different commentators use different terms for the starting point for this doctrine: "principal purpose," "reason for entering the contract," or "ultimate object of desire" have all been used. Some courts restrict the types of purposes they will consider, such as by rejecting claims that the primary purpose was "to earn money." Frustration of Purpose is generally applied to short-term contracts when one party's reason for entering the contract ceases to exist.

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3. Avoid litigation via proactive planning and professionally communicating.

Before resorting to fighting about these rare and uncertain exceptions to the requirement to perform, we recommend calling a meeting — which can be done virtually (as six feet of personal space has been encouraged) — to professionally and respectfully come up with a solution.

This can include coming up with a reasonable amendment to the contract; revising the construction schedule; and resetting expectations to reflect new realities. For future contracts, discuss and negotiate whether to include "pandemic" as grounds for a time-extension or another form of relief.

Construction lawyers are too often brought in too late. Consider calling our firm or another experienced construction law firm licensed in your state to help you proactively avoid and resolve disputes before they become unwieldy. Whether you want to allocate risk at the construction drafting stage or solve a potential issue up-front, bringing in qualified construction attorneys and consultants can be a cost-effective way to avoid costlier prolonged problems.

4. Evaluate whether existing insurance covers business interruption due to infectious disease or consider options for procuring such coverage.

Insurance can be procured to cover interruptions caused by infectious disease such as the Coronavirus. Some existing business interruption policies could potentially cover such impacts. Or the policy might expressly exclude communicable or infectious disease. There are challenges to business interruption coverage, and the law of the applicable state may impact what is covered. One of the largest independent claim managers has cautioned that "successful claims under business interruption coverage for infection are not common." But the legal issue of pandemics is rarely addressed.

Commercial property policies might also include coverage for losses caused by forced closure of property by civil authority, such as when an insured is unable to access its property because of a governmental order. Depending on the terms of the policy and the law of the state, physical damage to property may be required to trigger coverage.

Just as reading the full contract is important, reading the full policy is important.

Conclusion

Although construction contracts might not specifically enumerate a "pandemic" or "epidemic" as an excuse, it may make more sense to come up with an early resolution than to wait several months or years for a court to make a decision. After all, the common goals should be to complete the project safely, cost-effectively, and reasonably time-efficiently. Original expectations may need to be adjusted in light of the difficulties, fears, uncertainties, and new realities caused by a pandemic. Proactive management, professional communication, and proper planning are vital to keeping projects and people healthy.

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