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How the Corona Virus Affects Active Construction Projects

Introduction

The global spread of Coronavirus Disease 2019 (COVID-19) is generating unprecedented delays, disruptions, and uncertainty on construction projects. Travel restrictions, social distancing and quarantines are increasingly disrupting supply chains, contractor workforces and the availability of governmental personnel for project inspections, with resulting delays and increased costs. COVID-19's impact on construction projects has been mixed and varies by state. Many states considered construction an "essential" service, following guidance from the Federal Department of Homeland Security, which issued a non-binding list of 16 "critical infrastructure sectors." Other states and some local municipalities took a narrower view, requiring virtually all construction to cease. This panel focuses its discussion on key contractual provision interplay during Covid-19, actions of owners, contractors, and professionals during the pandemic, insurance coverage concerns, and legal defenses.

Key Contractual Provisions

The owner should carefully examine the construction contract to identify key provisions implicated by the pandemic. Each situation is fact-specific and contract-specific. While standard contract forms are widely used, the forms often are modified and standard terms and conditions frequently are changed based upon negotiations. Crucial provisions such as those addressing force majeure, notice time limits, compensable costs resulting from delays, risk allocation and damages limitations may be significantly different from the AIA standard forms and therefore each contract should be carefully reviewed and analyzed.

Contractually, events such as the COVID-19 pandemic generally do engage contractual provisions concerning the consequences of unforeseen events. These provisions commonly fall into two broad categories.

The first category concerns 'force majeure', which in broad terms refers to events unforeseeable at the time the contract was entered, outside the affected party's control,

that cannot be prevented or overcome, and result in a party not being able to perform some or all of its obligations. The COVID-19 pandemic could thus be understood as constituting a force majeure event. Under many forms of contract, a force majeure event would typically entitle a contractor to an extension of time for critical delay caused by the event, but not to compensation for costs incurred during the period of delay, except in agreed-upon circumstances. As always, the actual wording of the applicable clause(s) is important.

The following was language inserted into an AIA contract. It serves as an example of what a general contractor or even a subcontractor will want to steer clear of as it seeks to prevent an Owner from being on the hook for any additional costs associated with COVID-19. The Contractor alone would therefore bear the risk of additional costs:

Owner and Contractor recognize the existing and potential extraordinary measures being taken by governments, companies, and individuals due to COVID-19 and the potential impacts from the same on this Project. Owner shall not be liable to Contractor for extended overhead or any other delay damages, and the GMP shall not be increased, due to shortage of labor, materials or other causes of COVID-19.

The following is an example of language that seeks to protect the contractor/subcontractor to seek time / change-orders due to the pandemic:

Contractor shall not be liable for any delays, overruns (including but not limited to labor, material and/or costs) or impacts related to its work caused by or stemming from the COVID-19 pandemic as defined by the United States Centers for Disease Control and Prevention. In addition, Contractor shall be entitled to change orders for any and all time and costs relating to such pandemic. It is understood and agreed that this clause is in addition to and not in lieu of any force majeure clause already existent elsewhere in the contract.

Force majeure will typically only excuse non-performance of those obligations, which are affected by the specific event. This raises questions, for instance when certain activities (e.g., design activities) can be continued, while others cannot. The requirement that the consequences of force majeure cannot be overcome is also potentially significant, because a contractor may be able to take measures to allow the works to continue, although at a reduced rate.

A second type of contractual provision is relevant and may yield a different legal effect. It concerns changes in law (and directions given by public authorities).

Construction and engineering projects are being impacted due to governments passing laws or regulations, or even giving directives, intended to address the pandemic. Placing restrictions on the movement of people or goods between or within countries and requiring that certain people be 'locked down', usually represents a change of the law,

which has an impact – perhaps an impact even greater on a contractor’s ability to progress work than the pandemic itself.

“No damages for delay” (NDFD) clauses commonly found in construction contracts may or may not protect the owner from the contractor’s delay damage claims. Generally, these clauses are designed to protect the owner from a contractor’s delay damage claim by allowing a time extension, but no additional compensation, in the event of project delays. Courts generally enforce unambiguous NDFD clauses, but there are exceptions, one of which is for “delays not contemplated” by the parties.

Whether a NDFD clause protects the owner from pandemic-based delay damage claims will depend upon the clause’s exact language and is fact-dependent. In some instances, the delays may be deemed unanticipated, rendering the NDFD clause entirely ineffective. However, a limited NDFD clause (e.g., allowing delay damages after the first 30 or 60 days of delay) might be enforced. Also, where the contract specifically allocates the risk of delays caused by a pandemic, those clauses may be upheld, although such provisions are uncommon.

Actions/Duties of Owner, Contractor, Professional During the Pandemic

The owner should communicate with critical contractors, designers, and suppliers to assess the actual and potential impacts on contract performance and discuss how to potentially mitigate project disruptions to achieve the overriding objective – complete the project as soon as possible within, or as close as possible to, the budgeted costs. COVID-19 may impact design and construction contracts in a variety of ways, including impacts to supply chains, contractor workforces, designer personnel, and the availability of government inspectors.

The owner should consider directing its project management team to confirm that the contractor is taking appropriate site health and safety measures, including adhering to federal, state, and local guidelines as to distancing, cleansing, disinfecting, etc., and that sites are being properly manned and managed considering current circumstances.

When the decision is made to suspend the activities of the project, clear communication is key. Provide written notice to all design, construction, and consultant team members that includes, at a minimum, the provisions set forth in each agreement and prescribed delivery method of notices along with the following basic information:

- Document Field Conditions;
- Photographic documentation of Project site;
- Photograph current field conditions;
- Equipment on site;
- Consider aerial documentation via drone

In responding to delay notices, the owner should consider whether the notice qualifies as a “claim” or merely is an advance warning of potential delays, to which no formal

response may be necessary and perhaps should not be given. The owner should not respond unnecessarily in a manner that portrays it as unsympathetic or which could be misconstrued as directing activity that puts anyone at risk or acknowledging a delay claim that has been neither properly submitted nor supported. The contractor bears the burden to establish how a delay has impacted the work and should be regularly informing the owner of project impacts as information becomes available.

The owner should consider putting the contractor on notice of observed safety violations, including deviations from governmental or trade association guidelines for maintaining a safe construction site during the pandemic. Under the standard contract, the contractor is responsible for site safety, compliance with all applicable laws and dealing with emergencies on the site “to prevent threatened damage, injury, or loss.” However, the owner also may be liable for dangerous conditions, at times under statutory or common law, or possibly where it exerts control over the construction site, directs the contractor’s means and methods, or otherwise contributes to an injury. In those instances, the owner may be liable for failing to maintain a safe site, irrespective of contract terms placing primary responsibility on the contractor.

Under standard AIA contract forms, the contractor may terminate the contract if the work is stopped for thirty (30) consecutive days by government order or national emergency. In such circumstances, the contractor is entitled to recover “...payment for Work executed, as well as reasonable overhead and profit on Work not executed, and costs incurred by reason of such termination.” These provisions may incentivize the contractor to terminate the contract after a government-ordered 30-day shutdown by allowing recovery from the owner not just for work performed and termination costs, but also anticipated profit on work not performed, particularly where the contractor otherwise would be entitled only to a time extension due to COVID-19-based delays.

The contractor has a duty to mitigate and use all reasonable endeavors to minimize any delay in the performance of the contract. Both the contractor and the project manager have an obligation to give an early warning, as soon as either becomes aware of any matter, which could increase the total of the prices, delay completion, delay meeting a key date or impair the performance of the works in use. Following such a warning, the parties will meet in order to discuss ways to mitigate the effects of the matter. Failure by a contractor to give an early warning where an experienced contractor could have done so will be taken into account by the project manager in assessing any compensation event arising out of the same event.

The nature of what mitigation is possible will very much depend on the factual circumstances at hand. Contractors could, for example, consider alternative suppliers for goods, equipment and materials (where supply chains are disrupted) and adjustments to scheduling and resource management to reduce delays to completion; contractors should also retain evidence of all such efforts, irrespective of their outcome, so as to be able to demonstrate that mitigation efforts were made.

The standard of care for Personal Protective Equipment (PPE) and Design of open areas and existing building for hospitals exist because while some states have provided a waiver of liability for medical professionals, who are out of state or in retirement, who are serving those who are sick, we are unaware of any state where design professionals' liability is limited this way. If the means of site safety and social distancing stated by the contractor are not satisfactory to the architect related to protecting the architect's employees and consultants who must ordinarily visit the site, or in order to comply with regulatory mandates and policies, the architect may attempt to come to an alternative understanding with the contractor. If an understanding cannot be reached, then the issue could be escalated to the owner.

One alternative the architect and its consultants might consider and discuss with the owner and contractor is the feasibility of using technology to do site inspections if they feel in-person site inspections will not work. Development of a plan and protocols for "virtual site inspections" would depend on many factors, including the working relationship and levels of trust among the various parties (architect, owner, contractor, consultants), the particular nature of the items to be observed, and the specific intent of the visit.

For example, a general visit to certify applications for payment may differ from observations of concrete pours or inspections by the authority having jurisdiction that are key to structural integrity or health, safety and welfare (HSW) issues, the technology available, and informing the owner of potential shortcomings by not physically visiting the site to see the work in place.

Insurance Coverage Concerns

In light of Covid-19, the key players referenced above are seeking to get the necessary coverage to keep the project and, in many cases, the actual businesses, viable.

Builders Risk Policies

Builders risk policies are a type of property policy intended to cover buildings under construction, as well as the materials, supplies and equipment, and business interruption-related costs related to the cause of loss.

A typical coverage grant under a builders risk policy states: "We will pay for direct physical loss of or damage to covered property at the premises described in the declarations caused by or resulting from any covered cause of loss." Builders risk policies can also provide coverage for business interruption-related costs, but the key will be whether a COVID-19-related claim amounts to a physical loss. As many have already pointed out, there is a body of law discussing whether the presence of bacteria, odors, or microorganisms constitutes "property damage." There are also endorsements incorporated into such policies which may exclude many of those claims.

Most builder's risk policies contain a delay in completion endorsement (sometimes referred to as a delay in startup or "DSU" endorsement"). The delay in completion is of particular interest to contractors during the COVID-19 pandemic because it potentially provides coverage for losses, including "soft costs" associated with delay. Nearly every delay in completion endorsement has a sublimit for the loss and a deductible usually defined as a specific number of days.

The delay in completion coverage must be triggered by a covered cause of loss – meaning there must be direct physical loss or damage to the property insured. The question for these times is whether contamination by the COVID-19 virus of the covered property constitutes direct physical loss or damage.

One test case has already been filed in New Orleans by a restaurant seeking a declaratory judgment that its closure and costs of cleaning are a covered cause of loss under its first-party property policy. *See Cajun Conti LLC et al. v. Certain Underwriters at Lloyd's, London et al.*, No. 2020-02558, complaint filed (La. Dist. Ct., Orleans Parish Mar. 16, 2020).

An analysis of cases involving similar issues shows the potential for coverage. *See, e.g., Gregory Packaging, Inc. v. Travelers Property Casualty Co.*, No. 2:12-cv-04418, 2014 WL 6675934, at *6 (D.N.J. Nov. 25, 2014), the court held that the release of ammonia, which rendered a facility uninhabitable, was physical loss because, under New Jersey law, property can sustain physical loss without experiencing structural alteration. The court reached the same result applying Georgia law, holding that a fortuitous event rendered the property unsatisfactory and in need of repair. *Id.* at *7, and *Essex v. BloomSouth Flooring Corp.*, 562 F.3d 399, 406 (1st Cir. 2009), under Massachusetts law, an unpleasant odor rendering property unusable constituted physical injury to the property.

In *Oregon Shakespeare Festival Association v. Great American Insurance Company*, 2016 WL 3267247, Civil Action No.: 1:15-cv-01932 (D. Or. June 7, 2016), the plaintiff association operated open air venues and alleged coverage due to smoke from wildfires in the area. The insurer defended on the basis there was no actual physical damage to the property itself. The district court found coverage stating: "In this case, wildfire smoke infiltrated the interior of the theater, making it uninhabitable and unusable for holding performances. Like the home infiltrated by methamphetamine odor, or the furnace contaminated by lead particles, or the facility filled with ammonia, the theater filled with smoke was unusable for its intended purpose. Even though the loss or damage was not structural or permanent, the property experienced a loss of "essential functionality." *Id.* at *9.

Pollution Liability Policies

Pollution liability policies may provide coverage for first-party and third-party claims arising from bodily injury, property damage, defense, cleanup, and related defense costs as a result of a sudden, accidental, or gradual release of a pollutant. Many such policies also include first-party business interruption coverage. Pollution covered by these

policies may include viruses, often under the definition of “mold.” If so, these pollution policies may cover business interruption costs. They could also cover the cost of decontamination of a project site if someone at the project site tested positive for COVID-19 and cleanup costs for the construction site must be incurred.

Commercial General Liability Policies

Commercial General Liability (CGL) policies insure against claims made against your business. While the initial wave of coverage disputes is likely to involve first-party policies, at some point, the different parties’ CGL policies may come into play.

Most CGL policies issued after the SARS outbreak of 2003 include an exclusion for any property damage or loss caused directly or indirectly by “[a]ny virus, bacterium, or other micro-organism that induces or is capable of inducing physical distress, illness or disease.” Even with such an exclusion present, however, a review of a specific policy is always worth the time, as endorsements to the policy can change or add coverage and are specific to each policy.

Some have inquired as to whether State or even Federal Government can intervene and remove some of the pandemic exclusions. This is unlikely. Virus exclusions are common in some policies (although not typically pollution policies). In 2006, ISO (Insurance Services Office, Inc.), the organization that writes and revises most standard insurance forms, recommended adding an exclusion for loss caused by disease-causing viruses or bacteria because of the possibility of future pandemics.

Since COVID-19 has become a full-fledged pandemic, certain state legislatures have considered bills to force insurers to pay COVID-19 business interruption claims. New Jersey, for example, considered a bill that would force insurers to pay COVID-19 business interruption claims that would have otherwise been expressly excluded by the ISO’s “virus” exclusion. That bill appears to be on hold indefinitely, following a backlash from the insurance industry and questions over the bill’s constitutionality.

Conclusion

The COVID-19 pandemic has created an enormous amount of uncertainty in terms of both its practical and legal implications for those involved in construction and engineering projects. Collaboration and good communication will be key to managing the impact and steering projects through this period of uncertainty. To this end, parties should pay careful attention to the notice provisions under their contracts and give appropriate and adequate notice(s) as soon as practicable and within any contractual deadlines. The potential and actual impact of COVID-19 on works in progress should be monitored carefully, mitigation measures taken where possible, and contemporaneous records made of the above. Termination is the most serious of the available remedies and advice should be taken on the impact of the governing law of the contract in addition to contractual terms before taking such a step.