MEMORANDUM

To: Markel Surety Underwriters and Claims Representatives

From: Steve Nelson, Senior Director, Surety Claims

Re: Issues for Contractors Presented by the Corona Virus Pandemic ("COVID-19")

Date: March 12, 2020

The following is not intended as a legal advice, nor a comment on the rights or responsibilities of any party to a specific contractual agreement, bond form, or particular set of facts. Rather, it is intended to educate you on a range of issues that may arise and suggestions as to possible proactive steps that might be taken by our principals and underwriters in these uncertain times. In all cases, our contractors are advised to seek their own independent legal advice based on the specific contracts and facts related to any project or claim situation. This memorandum was prepared with the benefit of, and some wholesale incorporation of parts of, several good briefing papers received from our outside counsel and others, including the Dickinson Wright, Smith Currie & Hancock, Langley, LLP, and Clark Hill Strasburger firms and ListServ ideas floated by my colleagues with the American College of Construction Lawyers and the International Academy of Mediators. There are many great minds brainstorming on construction and surety issues relating to COVID-19 and we are sure to come across further tips, check lists, and game plans as matters develop. We will do our best to keep you up to date on the latest thinking on such issues.

Although contraction of the Coronavirus ("COVID-19") fortunately remains a relatively low risk in the United States, COVID-19 still has the ability to "infect" a project schedule simply by reducing the supply of, or increase the cost of, labor and materials needed to complete their work. Supply lines may be interrupted. Material shortages or price escalations may develop. Travel may be restricted. There is no end to the havoc that the current COVID-19 situation might wreck on otherwise successful projects and contractors. Contractors should take precautionary measures and factor in possible labor and material delays to schedules, and any corresponding price impact, resulting from the spread of COVID-19. Contractors need to consider impacts not only in the United States, but for imported construction materials as well – especially long lead items or materials from highly infected areas (i.e., Italian marble or Chinese steel). If faced with projects requiring materials from highly affected areas, alternate or substitute materials may be an appropriate approach to stay on schedule.

Modern construction contracts commonly contain provisions addressing risks of delays resulting from *"force majeure"* (translated from French as "superior force") and other events and circumstances beyond the control of the parties to the contract. Contractors should discuss potential delays and cost impacts due to COVID-19 during negotiation of the construction

documents. Although it is reasonable to argue delay impacts from COVID-19 is a *force majeure* event that should entitle a contractor to an extension of time, the AIA or ConsensusDocs form agreements do not specifically address pandemic events. Other manuscript or private forms of agreement may not include a force majeure clause or, worse yet, put such risks on the contractor. To avoid this potential issue, revisions to the standard construction documents, and careful review of all contracts and subcontracts, are required.

By way of example, §8.3.1 of the AIA A201 General Conditions identifies circumstances that may be commonly described or accepted as *force majeure* events, but the term "*force majeure*" is not used or mentioned in the document. Thus, to avoid future disputes (or worse, litigation) over delays and cost impacts due to COVID-19, contracting parties should consider adding the language to the AIA A201 agreement, perhaps along the lines as follows:

> *§ 8.3.1* **The Contract Time shall be extended and Contractor shall be entitled to an increase in the Contract Sum for its additional General Conditions and increased costs of labor and materials that are attributable to one or more of the following Impacts***: (1) an act or neglect of the Owner or Architect, of an employee of either, or of a Separate Contractor; (2) by changes ordered in the Work; (3) by labor shortages and/or disputes, fire, unusual delay in deliveries, unavoidable casualties;* **(4) disruptions in labor or materials resulting from a health crisis regardless of whether an infectious disease, epidemic, pandemic or isolated to areas from which such labor and materials are supplied***; (5) by delay authorized by the Owner pending mediation and binding dispute resolution; (6) by abnormal weather conditions; (7) by other causes beyond the Contractor's control that justify delay; (8) by adverse government actions, including but not limited to tariffs and embargoes; and/or (9) by any Act of God rendering performance of the Contract impossible or impractical. Any time gained by the Contractor on the Project Schedule shall not be offset against any delays as described herein.*

§6.3.1(j) of the ConsensusDocs 200 agreement references "epidemics" as a cause beyond the control of a Constructor, but it is wise to expand the definition in a similar manner noted above; to avoid any ambiguity, pandemic events are included as well. Potential price impacts may be addressed in the same section, or separately in the ConsensusDocs 200.1 Amendment No. 1 pertaining to Potentially Time and Price-Impacted Materials.

Similarly, the Federal Acquisition Regulations ("FAR") applicable to Federal projects, and often incorporated by reference in subcontracts on those projects, deals with such issues. FAR 52.249-14 states in part:

> *EXCUSABLE DELAYS (APR 1984)*
>
> ***(a)*** *Except for defaults of subcontractors at any tier, the Contractor shall not be in default because of any failure to perform this contract under its terms if the failure arises from causes beyond the control and without the fault or negligence of the Contractor. Examples of these causes are (1) acts of God or of the public enemy, (2) acts of the Government in either its sovereign or contractual capacity, (3) fires, (4) floods, (5) epidemics, (6) quarantine restrictions, (7) strikes, (8) freight embargoes, and (9) unusually severe*

> *weather. In each instance, the failure to perform must be beyond the control and without the fault or negligence of the Contractor. Default includes failure to make progress in the work so as to endanger performance.* (emphasis added)

Notably, the remedies granted in these provisions are only excusable time extensions, not additional compensation for the impacts. ConsensusDocs 200, Section 6.3 excludes epidemics, adverse governmental actions, and unavoidable circumstances from the causes for which the contractor is entitled to an equitable adjustment:

> (2) *In addition, if Constructor incurs additional costs as a result of a delay that is caused by items (a) through (d) immediately above, Constructor shall be entitled to an equitable adjustment in the Contract Price subject to §6.6.*

Similarly, FAR 52.249-14 addresses only a time extension for such impacts:

> *(c) Upon request of the Contractor, the Contracting Officer shall ascertain the facts and extent of the failure. If the Contracting Officer determines that any failure to perform results from one or more of the causes above, the delivery schedule shall be revised, subject to the rights of the Government under the termination clause of this contract.*

A court's or board of contract appeals' or arbitration panel's determination of whether delays caused by the spread of the coronavirus are excusable will depend on the specific facts and circumstances. A court may consider such factors as whether the length of the delay is reasonable; whether alternative pools of labor or sources of material could replace the pandemic-affected ones at a reasonable cost; whether the government shut down a project site or project management and for how long; and whether the government imposed an area-wide quarantine.

Even if a court, board, or arbitration panel finds that the delay was excusable, the language of the contract determines what, if any, remedies are available. If the contract has no *force majeure* clause, even a delay beyond the contractor's or supplier's control may not be excusable or compensable. The court will have to determine whether the purpose of the contract is entirely frustrated by the outbreak of coronavirus, nullifying it. It must also determine whether the contract affords only a time extension or compensation for damages related to the delay as well as considering what mitigating actions a contractor or supplier took to defray the delay and expense of the event.

Common to all force *majeure clauses* is the requirement to give written notice of the causes of delay. Generally, these clauses require notice to be given immediately upon the occurrence of the event that could impact performance, irrespective of whether the impact is ultimately incurred. Project participants should be hyper-vigilant about potential disruptions to their work, even erring on the side of providing advance warnings and notices of possible disruptions. To be prudent, contractors, subcontractors, and material suppliers should immediately make inquiries as to the status of pending orders and ability of counter-parties to fulfill upcoming orders.

When giving notice, project participants should (1) explain how the coronavirus qualifies as a force majeure or other excusable event under the contract; (2) provide as much specificity as possible about impacts to performance; (3) include any additional contractually-required information to the extent it is known; and (4) provide updates as more information becomes available. For contracts still in negotiations, parties should consider including provisions specifically tailored to possible impacts from coronavirus, including suspension clauses that can be implemented on short notice and equitable adjustments to contract prices to account for disruptions and other impacts to performance.

Dodge Data & Analytics estimates that building product imports from China account for nearly 30 percent of all U.S. building product imports, making China the largest supplier to the U.S. Accordingly, current and continued disruptions to supply chains portend an almost certain impact to prices of construction products and materials. While contractors in the U.S. have already incurred or been notified of delays to construction materials, the U.S. has not felt the full cost impact of disruptions to the supply chain caused by coronavirus. To protect against or mitigate these impacts, project participants should be fully aware of contract provisions addressing price escalation.

To the extent that *force majeure* clauses do not provide financial relief for qualifying impacting events, contractors and subcontractors will need to look to escalation clauses in their existing contracts and/or consider including such provisions in future agreements for relief. Common escalation clauses specify the materials subject to escalation and define the events that trigger the clause. Often, the triggering event is a specified percentage increase in a standard price index. Other clauses call for making price adjustments at fixed intervals (quarterly, annually, etc.) or upon certain project milestones.

Given the uniqueness of coronavirus, project participants should consider escalation clauses tailored to the circumstances with provisions flexible enough to account for the fast-changing impacts associated with the spread of the disease. These clauses should establish standards for documenting and proving the cost increases, including the exhaustion of alternative sources of supply.

To complicate matters, clarifying that a change is necessary to deal with these issues may create an inference that the unchanged documents do not already provide the protections a contracting party may suggest to be applicable. Thus, careful thought should be given when a party has an ongoing relationship with an owner and general contractor and claims under existing contracts are possible.

No doubt, issues will arise on contracts, subcontracts, and bonds in force that did not have the benefit of some advance thought on the eventualities of a worldwide pandemic. In some instances, *force majeure* clauses are written with sufficient breadth that the pandemic may be consider “acts of God,” “embargoes,” or “causes beyond the contracting party’s control.” And, absent a *force majeure*, or escalation clause, parties may resort to theories of “impossibility of performance,” “frustration of performance,” “impossibility,” “unforeseen conditions not leading

to a meeting of the minds," Uniform Commercial Code § 2-615 "Excuse by Failure of Presupposed Conditions" and similar arguments and theories, all of which have bubbled up in many contexts in the past…Gulf War, 911, Chinese Steel embargo, energy crisis, sick buildings, Legionnaire's Disease, and any number of other curves thrown at society in the past. The Courts have not always relieved contractors from these risks, taking the position that these were business risks intentionally undertaken. In this situation, however, I believe they might come down more in favor of relief.

The implications for sureties remains to be seen, but our contractors are going to see some bumps in the road. Importantly, they should seek counsel of experienced construction attorneys before taking action on pending issues. "Walking off," terminating, or taking unilateral action are typically not remedies available in these circumstances…no matter how dire the delay or cost impact. Please urge any of our principals to contact me or someone in our contract claims department with questions and concerns before taking any of those steps. We cannot provide them with specific legal advice, but can consult with them on options and courses of action they or we may wish to take.