

How Will Coronavirus Impact Your Company Contracts

The impact of COVID-19 on companies and their contracts is worsening, with potential implications for supply chain disruptions and labor shortages.

The construction industry in particular relies heavily on foreign suppliers and manufacturers for materials, such as steel and plumbing and electrical equipment. Unfortunately, the COVID-19 outbreak has led to widespread quarantines, travel restrictions, and business closures, meaning production and transportation of goods has stopped or slowed significantly. This is expected to result in higher costs and price fluctuations, material and labor shortages, order cancellations, logistics problems, and delays across the supply chain process. Contractors may be forced to find alternative sources of materials and/or labor, which would likely result in added costs in terms of more increased overhead and potential claims by project owners due to delays. Now that I've set a bleak scene, let's discuss who bears risk and loss and how companies can protect themselves.

Who bears the risk and the loss for increased construction costs and delays?

This is largely determined by the controlling written contract and, in particular, a force majeure clause, if one exists. Force majeure clauses can vary slightly but in essence, they allocate risk in the unanticipated and extraordinary event that performance is delayed, stopped, or rendered impossible, impracticable, or illegal due to circumstances outside the party's control. Force majeure events often include "acts of God," such as hurricanes, fires, tornadoes, and earthquakes, as well as man-made circumstances like wars and terrorism.

What actions can you take now if your project is or may be impacted by COVID-19?

1. Document in detail the impact that COVID-19 has on the project, including the extent to which the outbreak has prevented, hindered, or delayed performance.
2. Explore options for mitigating damages and delays, including potential alternative means for performing obligations.
3. Evaluate insurance policies for potential business interruption coverage, noting specific terms and conditions such as notice provisions.
4. Review existing contracts to determine if a force majeure clause exists, and if so, whether a pandemic constitutes a force majeure event.
5. Confirm what law governs and what the force majeure clause covers. For instance, does it provide for suspension or discharge of performance, extend the completion date, reallocate liability for any damages, and/or provide for additional costs?
6. Determine if any notice provisions apply to invoke a force majeure clause.
7. Comply with requirements for evidence or documentation regarding the impact on the project and/or mitigation efforts.

How can you protect your business against future risks and impacts?

It's unlikely that this will be the last outbreak or pandemic to disrupt commerce. To protect your business and account for uncertainty, include force majeure clauses in your contracts. Be specific and clear in defining the scope and effect of force majeure clauses. Ensure you address elements such as:

- What events trigger the force majeure clause?
- What factors do parties assess to determine whether an event renders performance impossible, impracticable, or illegal?
- Who may invoke the clause?
- Who can or is responsible for suspending performance?
- Which specific contractual rights and obligations are covered by the clause?
- How will parties handle force majeure events that extend indefinitely or longer than a specified period of time?

Contractors may also consider price acceleration clauses to allow for adjustment of the contract price to reflect revised actual costs due to labor and material price increases. Though largely disfavored by prime contractors and project owners, price acceleration clauses can even include a termination for convenience provision to allow the contractor to terminate a contract if the cost of materials has increased exponentially or the materials themselves have become difficult or impossible to find.

What about insurance?

Many commercial property insurance policies do provide for business interruption coverage. Such policies, however, often include standard, universal exclusions that would likely encompass pandemics. Commercial property insurance policies may also require direct physical loss of or damage to property, which is unlikely to result solely from a pandemic. Accordingly, policies must be reviewed carefully to evaluate coverage availability and applicability.

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