



# Construction/Maintenance Contracts: What You Need To Know During the Pandemic

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# Contracts

- ▶ Contractual terms are important because they will generally control and be enforced between the parties to a contract when an issue arises
  - ▶ Not all issues/events are foreseeable, however it is beneficial to include contract provisions for those that are foreseeable
- ▶ Review contracts for: force majeure, delay, termination, damage, and attorneys' fees provisions
- ▶ What happens when contractual obligations are unable to be met or are substantially impacted by the COVID-19 Pandemic?



# Contracts: Force Majeure Provisions

- ▶ Force Majeure Provisions excuse a party's performance of contractual obligations upon the occurrence of certain specified events
  - ▶ California courts interpret these provisions to include listed events, as well as events unforeseeable at the time the contract was entered
- ▶ If express force majeure language is not included, California law provides for the implied excuse of performance for force majeure events (Cal. Civil Code § 1511(2))

# Contracts: Force Majeure Provisions

- ▶ California's test for the presence of a force majeure event is "whether... such an insuperable interference occurring without the party's intervention as could not have been prevented by the exercise of prudence, diligence and care" (*Pac. Vegetable Oil Corp. v. C.S.T., Ltd.* (1946) 29 Cal.2d 238)
- ▶ California courts have not published a decision dealing with a virus or pandemic in relation to contracting and equitable principals
  - ▶ California Supreme Court has made clear that the party seeking to have their obligations excused must prove more than just a greater expense or hardship than anticipated and that sufficient and reasonable efforts were attempted to avoid the consequences of the triggering event

# Contracts: Force Majeure Provisions

- ▶ Force majeure is equivalent to the common law contract defenses of impossibility and frustration of purpose which will excuse contract performance when there is:
  - ▶ An unforeseeable event
  - ▶ Outside the parties' control
  - ▶ Rendering performance impossible or impractical
- ▶ After it is determined that a force majeure event occurred, a determination is made as to whether the circumstances warrant a delay in contract performance, or a complete termination of all obligations

# Contracts: Force Majeure Provisions

- ▶ Issues arising from contract interpretation and defenses are very fact-dependent and the litigation of such matters can be expensive
- ▶ Ensure your contracts include protective provisions
- ▶ Don't be afraid to reach out to your clients and explain why the contract can't be performed and attempt to resolve any issues outside of litigation



# Contracts: Mitigating Delays to Project Starts and Finishes

- ▶ Shutdown/Delay Due to Change of Law or Emergency Order
  - ▶ Upon written notice to Owner, Contractor reserves the right to extend the contract performance period by the time that is necessary to reach compliance with the change of law or by the duration of the emergency order
  - ▶ This may also be addressed in the Contract's force majeure provision
- ▶ Shutdown/Delay Due to Supply Chain and/or Labor Force Issues
  - ▶ This may also be addressed in the Contract's force majeure provision



## Contracts: Unanticipated Costs for Safety Requirements and Public Health Orders

- ▶ California law requires that a firm price be given when the contract is executed for home improvement contracts (Cal. Bus. & Prof. Code § 7159)
- ▶ These costs should be included in your original contract price
- ▶ It may be possible for some of these costs to be included in a change order to the contract
- ▶ Unanticipated costs cannot just be passed along to the client without new consideration on the contractor's part

# Contract Amendments and Novations: When Parties Still Want to Contract

- ▶ Amendment/Modification: California Civil Code 1698.
- ▶ (a) A contract in writing may be modified by a contract in writing.
- ▶ (b) A contract in writing may be modified by an oral agreement to the extent that the oral agreement is executed by the parties.
- ▶ (c) Unless the contract otherwise expressly provides, a contract in writing may be modified by an oral agreement supported by new consideration. The statute of frauds (Section 1624) is required to be satisfied if the contract as modified is within its provisions.
- ▶ (d) Nothing in this section precludes in an appropriate case the application of rules of law concerning estoppel, oral novation and substitution of a new agreement, rescission of a written contract by an oral agreement, waiver of a provision of a written contract, or oral independent collateral contracts.

# Contract Amendments and Novations: When Parties Still Want to Contract

- ▶ Novation: California Civil Code Sections 1560-1532
- ▶ 1530. Novation is the substitution of a new obligation for an existing one.
- ▶ 1531. Novation is made:
  - ▶ 1. By the substitution of a new obligation between the same parties, with intent to extinguish the old obligation;
  - ▶ 2. By the substitution of a new debtor in place of the old one, with intent to release the latter; or,
  - ▶ 3. By the substitution of a new creditor in place of the old one, with intent to transfer the rights of the latter to the former.
- ▶ 1532.
- ▶ Novation is made by contract, and is subject to all the rules concerning contracts in general.

# Contract Amendments and Novations: What is the difference?

- ▶ An Amendment is a change to the terms of the existing Contract, for NEW consideration. (Consideration being the items being transferred between the parties. More time for less money, more time for waiver of delay damages, Change orders of a new material for more money).
- ▶ A novation is the substitution of a new obligation for an existing one. The effect of a Novation is the termination and discharge of the old rights and obligations, for the creation of a new contract with new or the same rights and obligations. Novations are usually argued in CA as an affirmative defense to an allegation of breach. See ACI No. 337. Affirmative Defense—Novation

# Contract Amendments and Novations: What is the difference?

## Amendment

- ▶ A CHANGE to the terms of the existing Contract
- ▶ New Consideration required from both parties
- ▶ Timeline, and deadlines do not change

## Novation

- ▶ A SUBSTITUTION of a new obligation for an existing one.
- ▶ Termination and discharge of the old rights and obligations,
- ▶ Creation of a new contract with new or the same rights and obligations.
- ▶ Could trigger Mechanics lien, stop payment notice, or other recovery deadlines for completed work

# Contract Amendments and Novations: Why does it matter?

- ▶ California law bases timers in construction law on the substantial completion of construction contracts. With an Amendment, the Contract is continuing, and the completion timers do not start, but with a Novation, it is arguable that the old contract has ended and therefore the timers for financial recovery have started.



# Contract Amendments and Novations: When to use either?

- ▶ Using an Amendment: You and the client are already contemplating new consideration between the two of you.
  - ▶ An expansion to the contract for more money, or a reduction of obligations for less money. EX: Change Orders
  - ▶ But an amendment without new consideration could be voidable, or could be a novation depending on phrasing.

# Contract Amendments and Novations: When to use either?

- ▶ Using a Novation: You and the client want to restart the contract.
  - ▶ You both might have breached or you both want out of the old contract.
  - ▶ You both don't need new consideration. This can clean up the legality and status between the two parties,
  - ▶ But is more complicated and may trigger timers, which makes it an ideal option when both parties are not in dispute about money.



# Contract Amendments and Novations: Drafting Either

- ▶ Drafting an Amendment: You and the client need to clearly state that it is a modification of the previous contract AND must clearly state the NEW consideration from each Party.
  - ▶ EX: Typical Change Orders: Granite for more money. Waiver of late payment fees for more time to complete the job.
  - ▶ Owen the Owner agrees that he would like to add a water fountain to his garden. Conny the Contractor agrees to perform the original contract and the additional work for an additional sum of \$3000. (You can honestly add new PPE operating expenses here)

# Contract Amendments and Novations: Drafting Either

- ▶ Drafting a Novation: You and the client need to clearly state that it is a Novation of the previous Contract (reference the exact documents and attach as an Exhibit), AND both parties intend and consent to termination of the old contract and its substitution for a new contract.
  - ▶ EX: An entirely new construction Contract with the old one attached. Could be very different or mostly the same as the last. Perhaps best to run by Counsel....
  - ▶ Owen the Owner originally contracted to have Conny the Contractor plant an orchard. But now that planting season has passed due to COVID-19, Conny could not work, Owen would like Conny to plant a sunflower patch instead. Conny drafts a Novation, to replace the old orchard contract with the new sunflower contract. (Conny can now also include the additional PPE expenses into a Novation)

## Payment Issues: Mechanics Liens

- ▶ Even in the current climate, the mechanics lien remains a valuable tool for contractors and material suppliers who have not been paid
- ▶ Pay attention to your deadlines for recording a mechanics lien
- ▶ Allow plenty of time for recording: Don't wait until the last day to record
  - ▶ Many County Recorder's Offices are still generally closed to the public, while you are able to record your mechanics lien it will take longer than usual
- ▶ Pay attention to the 90-day deadline to file your mechanics lien foreclose lawsuit after recording your mechanics lien and file on time

# Payment Issues: Client Bankruptcy

- ▶ Being a Creditor in Bankruptcy
  - ▶ Secured v. Unsecured Creditor
    - ▶ Do you have a mechanics lien?
    - ▶ Has the mechanics lien been perfected?
    - ▶ Other tools
- ▶ Preferential Payment Rule
  - ▶ Allows the Debtor's Estate to recover payments made to creditors in the 90 days leading up to the Debtor's bankruptcy filing
  - ▶ Exceptions to the preferential payment rule exist for certain payments, including those made in the ordinary course of business

## Payment Issues: Negotiated Settlement

- ▶ The ultimate goal is a negotiated settlement and final payment
- ▶ **WARNING:** Never surrender an unconditional waiver and release on final payment, or release your mechanics lien without confirmation that the final payment has cleared the bank!!!



# Indemnity: What is it? Contractual per code, or Equitable as Implied in the Contact

California Civil Code Sections 2772-2784.5

- ▶ Section 2772:
  - ▶ Indemnity is a contract by which one engages to save another from a legal consequence of the conduct of one of the parties, or of some other person. AND
- ▶ Section 2779:
  - ▶ Where one, at the request of another, engages to answer in damages, whether liquidated or unliquidated, for any violation of duty on the part of the latter, he is entitled to be reimbursed in the same manner as a surety, for whatever he may pay.

# Indemnity: 3 Types of Indemnity in California

- ▶ TYPE 1: A Type I clause is one which expressly and unequivocally provides that the sub-contractor (indemnitor) is to indemnify the general contractor (indemnitee) for the negligence of the general contractor (indemnitee).
- ▶ EX: “The Subcontractor agrees to save free, the General Contractor and hold harmless, of and from, any loss or liability, of any nature whatsoever arising out of or in any way connected with the subcontractor’s performance of this Agreement, including loss or liability caused by the General Contractor’s active negligence, except loss or liability caused by the General Contractor’s sole willful conduct or active negligence.”

## Indemnity: 3 Types of Indemnity in California

- ▶ TYPE 2: A Type II clause is one which provides that sub-contractor (indemnitor) is to indemnify the general contractor (indemnatee) for the negligence of the general contractor (indemnatee) caused by indemnatee's own acts of "passive negligence." Passive negligence is when there is a mere nonfeasance.
- ▶ EX: "The Subcontractor agrees to save free, the General Contractor, and hold harmless, of and from any loss or liability except that caused solely by the General Contractor's negligence of any nature whatsoever." (Exception Includes , malfeasance or willful conduct.)



# Indemnity: 3 Types of Indemnity in California

- ▶ TYPE 3: A Type III clause provides that subcontractor (indemnitor) is to indemnify the general contractor (indemnitee) for the general contractor's liability (indemnitee) if caused by the subcontractor (indemnitor) BUT excludes indemnification for liability that was caused by someone other than the subcontractor.
- ▶ EX: "Subcontractor promises to indemnify the General Contractor from liabilities caused by subcontractor arising directly or indirectly from the performance of the contract or work, regardless of responsibility for such negligence; provided, however, that nothing in this agreement purports to or should be understood to provide for indemnity of a General Contractor for its sole negligence or willful conduct."

## Indemnity: Executive Order N-62-20 Workers' Compensation Presumption, May 5, 2020

- ▶ “...IT IS HEREBY ORDERED THAT:1)Any COVID-19-related illness of an employee shall be presumed to arise out of and in the course of the employment for purposes of awarding workers’ compensation benefits...”
- ▶ “...2)The presumption set forth in Paragraph 1 is disputable and may be controverted by other evidence, but unless so controverted, the Workers’ Compensation Appeals Board is bound to find in accordance with it. This presumption shall only apply to dates of injury occurring through 60 days following the date of this Order...”
- ▶ Almost impossible to rebut without testing and contact tracing
- ▶ But ends July 4, 2020.

# Indemnity: Medical and PPE Obligations

- ▶ Why it all matters?
  - ▶ GCs and Owners are starting to force Subcontractors to absorb the liability (including their WC expenses) of a COVID-19 outbreak by their indemnity clauses in several ways:
    - ▶ 1. Through the indemnity clause directly via health screenings at the access site or affidavits of health screening.
    - ▶ 2. Through violations of the health orders, or CDC recommendations such as social distancing observed as not followed
    - ▶ 3. Through the violation of OSHA such as employees lacking masks, gloves, glasses, other PPE.

# Indemnity: Wavier of Worker's Compensation Immunity

- ▶ Labor Code Section 3602:
  - ▶ “...(a) Where the conditions of compensation set forth in Section 3600 concur, the right to recover compensation is, except as specifically provided in this section and Sections 3706 and 4558, **the sole and exclusive remedy of the employee or his or her dependents against the employer....”**
- ▶ This code section limits a claim from an employee to its employers, but an infected/injured employee could still go after the Owner or general contractor for negligence or disregard of CDC/OSHA orders.
- ▶ SO, GCs will seek Wavier of these provisions in their contracts. Strike these waivers if you can. Order best as the landscaper to contract directly with the Owner.

QUESTIONS?

