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Force Majeure: Risk Allocation for Unforeseeable Events

By Timothy S. Taylor and Allison O. Kahn



Timothy S. Taylor

When a hurricane brings a construction project to a stop, who pays for the delay? When access to a security-sensitive construction site is severely restricted because of newly promulgated, post-9/11 terrorism security measures, who pays for the contractor's loss of productivity? When worldwide natural disasters cause the price

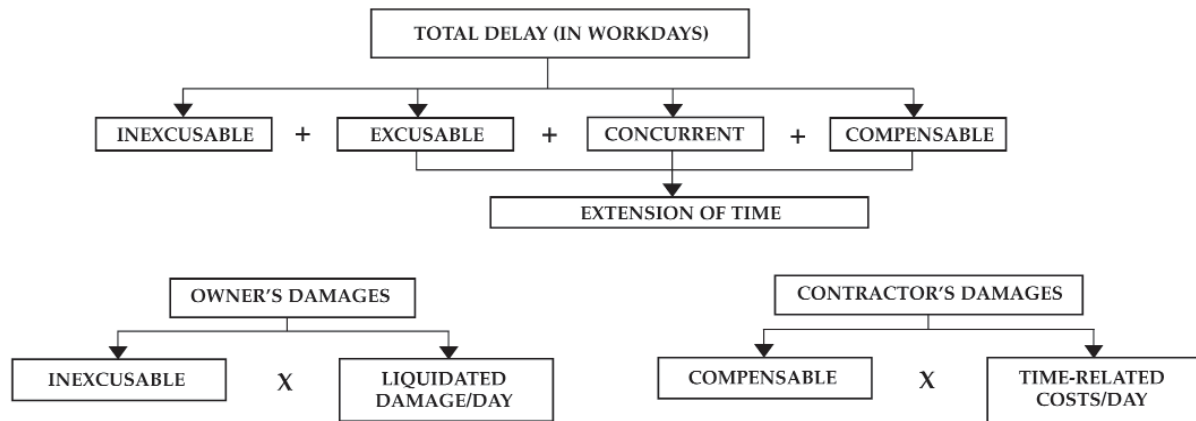
Allison O. Kahn

of building materials to skyrocket, who should bear the extra costs? The answers to these questions should be found in the force majeure provisions of the parties' contracts.

Force majeure, or the Latin expression *vis major*, describes the particular circumstances that may excuse per-

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Exhibit 5: Delay and Related Damages Calculations



between the events causing disruption and delay and the resultant costs generally provides valuable information from which the owner can evaluate liability and quantum aspects of the claim.

A more detailed discussion of this topic will be included in the Construction Claims chapter of the upcoming Litigation Services Handbook published by Wiley Press.

Stephen Lechner is a principal of PricewaterhouseCoopers L.L.P. in San Francisco,

CA, where he leads the Construction Advisory Services practice in the United States. He can be reached at (415) 498-6596 or stephen.p.lechner@us.pwc.com.

Force Majeure

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formance under a contract when an act of God or some other supervening event occurs beyond the control of either of the parties.¹ In determining whether a force majeure event has occurred, the test is “whether under the particular circumstances there was such an insuperable interference occurring without the party’s intervention as could not have been prevented by the exercise of prudence, diligence and care.”² In other words, the force majeure event has to be (1) not reasonably foreseeable in the ordinary course of the industry and (2) beyond the reasonable control of the party.³

Drafting the Force Majeure Clause

Force majeure clauses can shift the risk allocation from the promisor, who is providing the labor, materials, or service, to the promisee, who has agreed to pay for and accept the labor, materials, or service.⁴ For example, a contractor may demand that a force majeure clause be inserted into the general contract to allo-

cate to the owner the risk of loss in the event that unforeseeable delays occur for reasons beyond the control of the contractor. Similarly, a subcontractor or supplier may place a force majeure clause in its subcontract or supply contract to shift the risk to the contractor for unforeseeable delays that are beyond their control. In the absence of a force majeure clause, the performance risk is presumed to rest with the promisor.⁵

Enforceability of a force majeure clause is determined by the intent of the parties, which is evidenced by the language in the contract.⁶ The terms of the contract will be enforced with common law rules merely filling in gaps left by the document.⁷ “In other words, when the parties have themselves defined the contours of force majeure in their agreement, those contours dictate the application, effect, and scope of force majeure.”⁸ Consequently, parties to a construction contract should draft the force majeure provision with care, mindful of the risks that they may encounter, especially in light of lessons learned from recent disasters.

For example, a force majeure clause may provide that:

Neither party will be liable for any breach or failure to perform under this Agreement or any other documents incorporated by reference herein if such breach or failure to perform is due to acts beyond the reasonable control of such party, which include by way of illustration, acts of God or public enemy, acts of Federal, state or local government, either in its sovereign or contractual capacity, fire, floods, civil disobedience, strikes, lock-outs, freight embargoes, inclement weather, or any other cause or conditions beyond such party’s reasonable control; provided, however, that the party which has been so affected will (i) promptly give written notice to the other of the fact that it is unable to so perform and the cause(s) therefore; and (ii) resume its performance under this Agreement immediately upon the cessation of such cause(s).⁹

As illustrated in this example, force majeure clauses often contain catchall phrases such as “or any other cause or conditions beyond such party’s reasonable control.” Such a catchall phrase must be construed within the context

established by the list of force majeure events that precedes it.¹⁰ Although such a broad term would suggest an expansive interpretation, the term will be limited to events similar to those specifically enumerated. In addition, the party seeking relief under the force majeure clause must show it exercised reasonable diligence to avoid the event.¹¹

Parties also should contract for the remedies available upon occurrence of force majeure events. Often, construction contracts and supply contracts will grant time extensions but no monetary relief. For example, a force majeure clause may permit an extension of the completion date but prohibit a contractor from claiming damages resulting from delay.¹² However, parties are free to contract otherwise. The negotiation of a force majeure clause should accurately reflect the ability of the parties to accept and allocate risk. Therefore, a contractor in a project located in a state where extreme weather conditions are possible may want to build a contingency risk into the price of the contract or negotiate terms for monetary relief in the event of delays resulting from such events.

Hurricanes and Natural Disasters

Parties to a construction contract should also consider whether to make provision for the impact of force majeure events on the cost of construction supplies.

Until recently, the inflation in building materials has been driven in large part by the rapid industrialization of nations like China and India, as well as by the enormous reconstruction efforts in Iraq and Afghanistan.¹³ However, the devastation of hurricanes and other natural disasters in the 2004 and 2005 hurricane seasons has caused fuel prices to skyrocket, and costs for lumber, plywood, cement, and steel are also expected to rise. Past natural disasters, such as Hurricane Andrew in 1992, inflated the price of building materials. Hurricane Andrew destroyed more than 28,000 housing units and was largely responsible for pushing the cost of plywood up 44.6 percent and the price of Southern pine framing lumber up 16.7 percent, according to the National Association of Home Builders. Compare those statistics with the roughly 200,000 homes

destroyed in the City of New Orleans by Hurricane Katrina and the picture starts to become clear. We can expect increases in the costs of most construction materials, including concrete, lumber, steel, and drywall. Furthermore, the rising fuel prices will no doubt increase the production and distribution costs of these materials.¹⁴

There can be no mistake that hurricanes and similar natural disasters will trigger a force majeure clause in a contract. However, a contract that only allows for time extensions is of no help to contractors, subcontractors, and suppliers facing potentially record-breaking increases in material costs and fuel

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expenses. Similarly, a contract that allows a contractor an extension of time or damages for delay usually will not cover the costs of construction materials that increase drastically as a result of the force majeure event. Consequently, to be protected, the party responsible for supplying such materials needs to include separate escalation clauses in its contract to absorb increases to material or labor costs. These clauses usually reference a general inflation index or a specific materials/industry index to be adjusted at specific intervals, that is, monthly, annually, and so on.¹⁵

Therefore, in the event that a project suffers massive increases in materials costs, such a provision allows the contractor to seek an increase in the agreed-upon price for these materials.

Terrorism and Government Policy

Since the unfortunate events of September 11, 2001, terrorism has become a well-known force majeure event. Terrorism can impact a construction project directly, as was the case in New York City, or indirectly, by affecting market conditions and increasing government security and regulation.

The issue of whether increased governmental antiterrorism security measures constitute a force majeure excuse for contractor delay was at issue in the recent decision of *Broward County v. Brooks Builders, Inc.*¹⁶ Brooks Builders, the contractor, filed suit against Broward County seeking compensation for delay damages on a project for construction of a fire station adjacent to the Fort Lauderdale airport. Although the project was not inherently complex, its location—adjacent to an active airport runway—presented significant challenges and numerous delays. Some of the delays were caused by a considerable increase in security measures on the active airport runway after the September 11, 2001, terrorist attacks. These delays occurred daily as the construction workers spent a substantial amount of time gaining access to the worksite through the security gates. The contract expressly required the contractor to comply with all airport security measures, but the contractor argued it could not have anticipated the extra measures put in place after 9/11.

The court found that although the parties may not have foreseen the extraordinary delays due to the September 11 terrorist attacks, their contract nonetheless had multiple provisions suggesting that the risk of loss for unexpected delays was to be borne by the contractor. Nevertheless, the contractor claimed relief under the following force majeure provision:

In the event that the Contractor is ordered by the Engineer, in writing, to suspend work for some unforeseen cause not otherwise provided for in the contract and over which the Contractor has no control, the

Contractor may be reimbursed for actual money expended on the work during that period for shutdown.

. . . No provision of this article shall be construed as entitling the Contractor to compensation for delays due to inclement weather, for suspensions made at the request of the Contractor, or for any other delay provided for in the contract, plans, or specifications.

The court disagreed with the contractor's interpretation of this provision, because the gate access delays resulted from the increased security measures implemented by the government, not from any order by the engineer. However, the court's ruling suggests that had the contract contained a force majeure clause allocating risk of governmental interference to the county, then the contractor could have recovered damages resulting from delay.

Courts traditionally have found that government policies that indirectly affect the economic conditions and profitability of a contract are not force majeure events. For example, in *Seaboard Lumber Co. v. United States*,¹⁷ Seaboard entered into a timber contract with the U.S. government to harvest timber on government lands. At the time the contracts were executed in September 1980, there was a housing boom, and the price of timber was high. However, between 1981 and 1983, the government allowed interest rates to rise in order to combat inflation, which led to a softening of the housing and lumber markets. This arguably caused many contractors to run into financial difficulties. Seaboard sought relief from the courts in order to invoke a force majeure clause in its contract for "acts of Government," which granted relief to the contractor where

[the contractor] experiences delay in starting scheduled operations or interruption in active operations either of which stops removal of Included Timber from Sale Area through curtailment in felling and buckling, yarding, skidding and loading, hauling or road construction, as scheduled under B6.31, for 10 or more consecutive calendar days during a Normal Operating Season due to causes beyond Purchaser's control, including but not limited to

acts of God, acts of the public enemy, acts of Government, labor disputes, fires, insurrections or floods.

Seaboard sought to invoke the force majeure clause for "acts of Government" that made its timber contract costly and unprofitable. Specifically, Seaboard argued that there were a number of government acts that occurred during the early 1980s that affected its contract—for example, new monetary control procedures and the deregulation of savings institutions—which led to an increase in interest rates and a slump in the timber market.

The court found that the force majeure clause listing "acts of Government" as an excuse for performance was not to be interpreted so broadly as to include government fiscal or monetary policy. Government acts or policies that were complained of had no more than an attenuated effect on the contract at issue and at most made performance of the contract unprofitable. Government policies that affect the profitability of a contract but do not preclude performance should not be considered "acts of Government" in the context of force majeure. Finally, the court reassured, "A force majeure clause is not intended to buffer a party against the normal risks of a contract. The normal risk of a fixed-price contract is that the market price will change."¹⁸

Force Majeure Insurance

Almost by definition, the damages resulting from a force majeure event can be disastrous. However, perhaps the best solution for allocating risk is for the owner to assume the risk and then insure against it. Force majeure insurance may include coverage for project completion, performance coverage, and delayed completion.¹⁹ Although a project is usually protected by "all-risk" insurance provided by the contractor, all-risk insurance usually does nothing more than cover the expense of repairing the work in place. However, it does not provide coverage for damages incurred by the owner for the delays incurred in completing the project, which often can be substantial. Therefore, force majeure insurance may be the best way to protect owners who are concerned about their investment

from unforeseen delay damages resulting from force majeure events.

Timothy S. Taylor is a member of the Construction Litigation Practice Group in the Miami office of Carlton Fields, P.A. He can be reached at ttaylor@carltonfields.com or (305) 530-0050.

Allison Oasis Kahn is a member of the Labor and Employment and Appellate Practice and Trial Support groups in the West Palm Beach office of Carlton Fields. She can be reached at akahn@carltonfields.com

Endnotes

1. See *R&B Falcon Corp. v. Am. Exploration Co.*, 154 F. Supp. 2d 969, 973 (S.D. Tex. 2001).
2. See *Mathes v. City of Long Beach*, 263 P.2d 472, 477 (Cal. Ct. App. 1953).
3. See *Stroud v. Forest Gate Dev. Corp.*, 2004 WL 1087373 (Del. Ch. 2004).
4. See *In re Westinghouse Elec. Corp. Uranium Contracts Litig.*, 517 F. Supp. 440, 459 (E.D. Va. 1981) ("the risk of a contingency that affects performance is presumed to rest on the promisor. However, the parties may agree to shift a particular risk to the promisee, or to allocate the various risks between them as they see fit.")
5. *Id.*
6. See *R&B Falcon Corp.*, 154 F. Supp. 2d at 973.
7. *Id.*
8. *Id.* citing *Sun Operating Ltd. v. Holt*, 984 S.W.2d 277, 283 (Tex. App. 1998).
9. 12 WEST'S PENNSYLVANIA FORMS, COMMERCIAL TRANSACTIONS § 2301, form 12.5.
10. See *Stroud*, 2004 WL 1087373 at 5; see also *Matador Drilling Co. v. Post*, 662 F.2d 1190, 1198 (5th Cir. 1981) (requiring party claiming force majeure to demonstrate that event of same general character as those specifically listed in clause occurred).
11. See *Stroud*, 2004 WL 1087373 at 5.
12. Wm. Cary Wright, *Force Majeure Clauses and the Insurability of Force Majeure Risks*, CONSTR. LAW., Fall 2003, at 17.
13. James Temple, *Cost of Building Expected to Rise*, CONTRA COSTA TIMES (S.F.), Sept. 9, 2005, at 2.
14. *The Katrina Premium: Facing Higher Construction Costs, Governments Need to Scrutinize Needs More Closely*, FORT WAYNE NEWS SENTINEL, Sept. 13, 2005, at A6.
15. Laurence P. Lubka, *What Can I Do About Those Steel Prices?*, CLAIMS RESOURCE, Fall 2004.
16. 908 So. 2d 536 (Fla. 4th Dist. Ct. App. 2005).
17. 308 F.3d 1283 (Fed. Cir. 2002).
18. *Id.* citing *N. Ind. Pub. Serv. Co. v. Barbon County Coal Co.*, 799 F.2d 265, 275 (7th Cir. 1986).
19. PHIL BRUNER & PATRICK O'CONNOR, BRUNER AND O'CONNOR ON CONSTRUCTION LAW, § 11.126 (2002); Wright, *supra* note 13.