

Practice Update

# COVID-19 Related Renovations: Key Terms Owners Should Include in All Construction Contracts

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By Stacy Bercun Bohm and Leslie Miller Tomczak

As businesses begin to reopen following the COVID-19 shut down of 2020, it is clear that the “business as usual” model will no longer work. Rather, companies have had to make changes not only in their policies and practices, but also in the construction and layout of their physical premises (whether it be a restaurant, store, doctor’s office, hotel, etc.) in order to maintain social distancing standards and to reduce the potential for infection. Renovations like this are essential in order to re-build consumer confidence and to encourage individuals to feel comfortable entering these establishments again. When hiring a construction contractor to perform such renovation work and/or to build a new premises that will be open to the public, there are a few key terms and conditions that every owner should include in their construction contracts:

1. Scope and Performance of the Work. As with any contract, it is crucial that the parties document the scope of services covered by the agreement. Oftentimes, this will include attaching not only a written description of the project and scope, but also a full list of, or actual copies of, the drawings and specifications issued by the applicable architect or other design professional. During the design of the project, it is crucial that the owner require its architect to not only design a project

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that will comply with applicable laws, but also one that will comply with all of the recommendations and guidelines promulgated by the U.S. Centers for Disease Control and the World Health Organization designed to reduce the spread of infectious diseases, such as COVID-19. Once the drawings and specifications are complete, the final permitted set needs to be attached and/or referenced in the construction contract and the contractor bound in the contract to perform its work in compliance therewith. Moreover, the contract should place the obligation on the contractor, at its own cost (or as part of the contract price), to ensure that its employees and other lower tiered subcontractors comply with all applicable governmental construction safety guidelines and any additional safety requirements of the owner when entering the owner's premises. This includes wearing personal protective equipment (PPE) like face masks, gloves, etc., and practicing social distancing during construction.

2. Contract Time. Two key terms to be included in any construction contract are: (a) the date the contractor is required to commence the work (the Date of Commencement), and (b) the date the contractor is required to achieve Substantial Completion of the work (the Contract Time). Both of these dates need to be negotiated and carefully drafted. The definition of "Substantial Completion" (which sometimes serves as the trigger for the commencement of warranty periods and release of retainage) also needs to be clear, and should require, at minimum, the completion of all work other than minor punch list work, and the receipt of a certificate of occupancy or local equivalent. The parties should also determine how long the contractor will be given within which to achieve "Final Completion" of the work (which should require, at a minimum, receipt of a final certificate of occupancy or local equivalent, completion of all punch list work, and receipt of all final affidavits, lien releases and other deliverables required by the agreement. If

the owner does not include these requirements in the contract, the owner could be required to make final payment before all of these conditions precedent are satisfied.

3. Delay Damages. When a contractor fails to complete its work within the Contract Time, the owner may sustain economic damages including, but not limited to, loss of profit, additional carrying costs such as insurance and taxes, additional fees that will have to be paid to architects and owner's representatives during the period of delay, and storage costs for FF&E and other items that should have been delivered and installed in the premises. Some of these damages, however, fit into the gray area of the law known as "consequential damages." Most of the industry standard construction agreements like the American Institute of Architects (AIA) and Design-Build Institute of America (DBIA) forms include a mutual waiver of consequential damages clause. What most owners do not know is that this "mutual" and seemingly innocuous clause can result in the absolute waiver by owner of any delay damages it may sustain due to the contractor's failure to complete its work on time. As such, the owner is wise to address this issue by either (a) asking that the waiver be removed, or (b) including a provision for liquidated damages for such a delay (which is the method typically more acceptable to contractors). The liquidated damages amount cannot be used as a "penalty." Rather, it needs to be an amount that the parties determine is reasonable based on the amount of economic damages that the owner is likely to suffer should a delay default occur.
4. Force Majeure / Delay Clause. Most construction contracts include language that covers how the parties will handle delays caused by owner or the contractor. However, another type of delay that needs to be addressed is a delay caused by events outside the control of either party, such as fire, casualty, acts of government, health epidemic or pandemic, or other force majeure type of events

(commonly known as an Unavoidable Delay). In the event of an Unavoidable Delay to the project schedule, the parties need to address whether, and to what extent, the contractor will be granted an extension of time to finish the project and, if so, whether any additional compensation will be paid for the period of delay (for example, to cover contractor costs such as additional equipment rental costs, labor costs, demobilization and remobilization costs, etc.). The contract also needs to address whether there will be any limitation on the type of delay compensation that will be permitted. If these issues are not carefully negotiated and included in the construction contract, the owner could face serious and costly delay claims down the road.

5. Price / Method of Payment. It is important to document not only the contract price, but how that amount will be paid. Will the work be performed by the contractor for a stipulated sum (meaning a lump sum, regardless of how much it actually costs the contractor to perform the work), or will the work be performed for the actual out-of-pocket cost of the work incurred by the contractor for the project, plus a pre-determined “fee” for overhead and profit (also known as a “cost plus fee agreement”)? For simpler contracts and/or small projects, the work will typically be performed for a stipulated sum (the contract for which is easier to negotiate and easier to administer). For larger projects and/or projects where the architectural plans will not be completed by the time the construction begins, parties will often agree to a cost plus fee form of agreement (with or without a guaranteed maximum price). This type of contract is more complicated to draft, negotiate and administer, and will require more advanced knowledge of construction law and construction contracts. However, it is important that these concepts are carefully negotiated and incorporated into the agreement so as to avoid misunderstandings and disputes at a later date.

6. Insurance. It is critical that the contractor hired for any construction project have proper types and amounts of insurance for the project at issue. Not only does it make sense to consult with legal counsel about these requirements, but a discussion with owner's insurance advisor/risk manager is also encouraged. At a very basic level, any contractor who is going to perform construction work for a construction project should have adequate levels of commercial general liability insurance, automobile liability insurance, workers' compensation and employer's liability insurance. Requirements for umbrella/excess coverage, pollution liability coverage, professional liability coverage (if the contractor has any design-build responsibility) and other coverage should also be determined based on the size of the job. If there is an accident or a defect in construction, it will be these policies that the parties will look to in order to cover the owner's potential damages. In addition to other requirements, the owner (and any other interested owner parties, landlords and/or lenders) should be named as "additional insureds" on the policies (except for workers' compensation), and all such policies should be primary and non-contributory to insurance policies maintained by the additional insureds.

7. Indemnity. The construction agreement should require that the contractor indemnify, defend and hold the owner (and other additional insureds) harmless for damages and other losses arising out of acts and omissions of the contractor and its lower tiers, including any claims against the Owner by the contractor's lower tiers for alleged non-payment by the contractor and resulting claims of lien. Note that many states have strict anti-indemnification laws that limit or prohibit an owner from requiring the contractor to indemnify the owner for damages or other losses to the extent they arise out of the negligence or other acts of the owner or its employees. Failure to comply with such laws may render the indemnification provision of the contract void in



its entirety. Thus, it is important to consult with legal counsel in the state at issue with respect to the drafting of the indemnification provision.

8. Landlord / Lender Requirements. If the owner has a landlord (i.e., the owner leases the property from another as a “tenant”), or has a construction loan, additional considerations need to be made as to what type of language needs to be included in the construction agreement in order to satisfy the owner’s obligations to its landlord and/or lender. Legal counsel should review the lease and/or the loan agreement in order to identify any specific requirements (such as insurance requirements, indemnification requirements, deliverables required for construction draws, payment and performance bond requirements, building rules and regulations, etc.) and include those in the construction contract. Failure to do so may inadvertently cause the owner to breach such agreements.

9. Licensure. Under the laws of most states, contractors must be licensed by the state to offer and/or provide contracting services. The type of license required depends on the type of project at issue. Moreover, many states make it illegal for someone to hire a contractor who is not properly licensed. As such, it is important to know what the applicable state’s requirements are, and to determine if the owner’s proposed contractor is in compliance. Most states have an online website where owners can search for their proposed contractor’s license number and status. This website may also allow owners to check to see if there have been any complaints made against the contractor’s license by former clients. A small amount of due diligence in the beginning of a project can go a long way in helping to avoid unlicensed (and thus, unqualified) contractors and potentially defective construction work.

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