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SOFTENING A HURRICANE'S BLOW: FORCE MAJEURE AND BUILDER'S RISK

by J.P. Vogel, Russell Jumper and Tim Fandrey
Construction Industry Team, Gray Reed & McGraw LLP
September 1, 2017



Hurricane Harvey caused severe destruction in Texas with its significant winds and historic rainfall. But Harvey may also prove to be a costly lesson for many project owners and contractors. As Texas begins to focus on recovery in the coming weeks, Harvey will further serve as a reminder to all construction industry stakeholders that hurricanes, and other “acts of God”, are risks that must be effectively managed during the pre-construction and construction phases of every project. While it is difficult to effectively avoid the risks attendant to a highly-destructive, low probability event that occurs on short notice, owners and contractors have two primary tools at their disposal to mitigate the effects of such an event: (i) contractual force majeure provisions; and (ii) builder's risk insurance.

Force Majeure

Force majeure events are events that are beyond the control of a contracting party. A properly drafted force majeure provision relieves parties of their contractual duty to perform upon the occurrence of a force majeure event. While the precise definition varies depending upon the language of the contract, generally, an event must be extreme to constitute an event of force majeure. Common examples within the context of construction contracts include war, famine, embargoes, and “acts of God” such as hurricanes, earthquakes and tornadoes. Although sometimes written off as “boiler plate” language—or in some cases completely ignored—the force majeure clause is crucial for impacted parties to obtain relief from performing their contractual duties.

Commonly accepted force majeure provisions are not without their pitfalls and limitations. They may be drafted too narrowly such that the particular event affecting a party does not meet the contract's definition of force majeure. Further, many force majeure clauses contain strict notice provisions that can result in a party accidentally or unknowingly waiving its right to the relief the force majeure clause provides if written notice is not given within the time prescribed by the notice provision. Providing strict contractual notice is likely the last thing on an owner or contractor's mind in the chaos that follows a force majeure event, and the notice deadline may lapse unnoticed. Even when force majeure clauses are properly invoked, the relief available is often limited by the terms of the contract. In most cases, the clause does not relieve a contracting party from ultimately performing its obligations, rather it temporarily relieves a party of its contractual obligations to perform only while the force majeure event actually prevents the party from being able to perform. It does nothing to address property damage to completed construction or construction in progress, stored materials, and cost impacts resulting from the delays caused by the event. Hence the related significance of builder's risk insurance.

Builder's Risk Insurance

Builder's risk insurance can fill in the gap left by the force majeure clause. It provides monetary relief for property damage and economic damages suffered as a result of a force majeure event such as Hurricane Harvey. As the name implies, “builder's risk” insurance covers loss and damages that occur during the course of construction—generally covering losses sustained by owners and contractors. The typical builder's risk policy covers the hard costs of construction, damaged or destroyed materials and equipment, completed or partially completed work, lost rent, and soft costs such as extended general conditions, bond premiums and real estate taxes.

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Too often, builder's risk insurance is overlooked in project preparation and planning. Construction contracts do not always expressly require a party to secure builder's risk insurance. Without an express directive to obtain the insurance, builder's risk insurance may be disregarded or considered "non-essential". Even when a builder's risk policy is in place, it may not adequately address the risks facing a particular project. Not all insurance policies are created equal and some provide greater coverage than others. There may even be differences in coverage within a particular policy. For instance, builder's risk policies often distinguish between flood water and wind-driven rain water. Although the water may have the same damaging effect on the constructed improvements, flood damage can be subject to a different coverage limit and deductible than rain damage. A policy holder must carefully review the policy language to ensure the coverage provided matches the possible risks during construction so there are no surprises with respect to insurance when tragedy strikes.

Bottom Line

Force majeure provisions and builder's risk insurance, when used effectively, can operate as a one-two punch to greatly mitigate the effects of an otherwise catastrophic force majeure event. However, taking full advantage of these tools requires forethought. It is crucial for the construction industry professional to take time ensure these tools are in place, and then provide any required notice when it becomes necessary. The stakes are high, so be sure to consult with a construction law attorney while engaging in due diligence for your next project.

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J.P. is a trusted advisor and litigator for businesses and individuals involved in the construction industry throughout Texas and the United States. His clientele includes owners, general contractors, specialty sub-contractors, suppliers, and manufacturers. For many of his clients, J.P. routinely provides counsel regarding their daily business operations including litigation, collection services, labor and employment issues, defect and insurance issues, drafting and negotiating agreements, and corporate governance. (jpvogel@grayreed.com)



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