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Potential Surety Coronavirus Defenses

By David A. Harris and J. Jackson Harris March 24, 2020

The spread of the novel coronavirus known as COVID-19 slammed the markets over the past several weeks, and some industries – in particular, the hospitality industry – have already taken a massive hit. The full extent of the pandemic's impact on the economy remains unclear. But with entire countries effectively shutting down, and many citizens and businesses doing what they can to enact the "social distancing" recommendations of disease experts, it stands to reason that the construction industry will face serious problems with their supply chains and labor pools over at least the next several months.

These problems are bound to have an impact on surety claims. Facing supply chain and labor problems, many contractors will find it difficult, if not impossible, to satisfy their contractual obligations. Construction contracts are not often drafted on the assumption that a massive economic shock is around the corner. Certain terms – including those requiring timely completion and imposing liquidated damages for delay – will be coming into play more and more over the next several months. Moreover, some contractors, with already slim profit margins, may go under before normal business operations resume.

Although construction contracts themselves may not be drafted with an eye toward future economic shocks, the law does provide potential defenses to contractors and sureties who find themselves unable to satisfy the strict terms of their agreements. Any surety faced with a contract default or payment bond claim which may be caused by the coronavirus would do well to review these defenses and consider their application.

First and foremost, for centuries courts have recognized a defense to breach of contract based on *force majeure* (Latin for "superior force") or an "Act of God." In Georgia, for example, the legislature has codified the Act of God defense at O.C.G.A. § 13-4-21, which provides that "[i]f the performance of the terms of a contract becomes impossible as a result of an act of God, such impossibility shall excuse nonperformance, except where, by proper prudence, such impossibility might have been avoided by the promisor."

Although we might have to dust off our history books to find them, very old judicial decisions make clear that "pestilence" and disease are the sorts of events that can excuse contract performance. But before looking to old judicial decisions, a surety should look to the construction contract itself. Many construction contracts contain *force majeure* clauses that define these terms to include disease and specify what impact the defined event will have on the contractor's obligations.

Other, similar defenses may also be available. Georgia courts have recognized a defense based upon impossibility of performance. In cases where the government's response to the spread of the virus affects a contractor's ability to perform – for example, in the event of a government-imposed lockdown – impossibility may be the more appropriate defense. Construction contracts also often contain provisions

outlining which party bears the risk of loss in the event governmental regulations preclude performance. Some states go further, recognizing a defense where performance is merely impracticable.

The viability of these potential defenses will likely depend upon *objective* considerations. If other contractors would not have difficulty performing, the defense will probably not be available. Moreover, increased cost or increased difficulty alone are unlikely to form the basis of a successful defense.

The limitations of these defenses can be found in *Felder v. Oldham*, 199 Ga. 820, 35 S.E.2d 497 (Ga. 1945), where the Georgia Supreme Court determined that World War II was not an unforeseen event that would support an impossibility defense to the termination of a contract entered before the outbreak of war. The court determined that "in the light of human history" it could not hold that war was "an unforeseen casualty; on the contrary, war is something which may be anticipated, as unpleasant as it is to do so, and against which parties can protect themselves by contract." *Id*. at 825.

The application of these defenses will be fact intensive. Further, the scope of these defenses varies from state to state. For both reasons, it is impossible to provide bright-line tests to determine whether the defenses might apply to a given claim. But, if a bonded principal's or surety's ability to perform is jeopardized by governmental restrictions or other effects of the virus, it would be worthwhile to review the contract to determine whether it contains terms that vary the default legal rules and assign the risk of loss to one party or the other. Moreover, the documentation of the obstacles faced in seeking to perform a bonded contract will be the best preparation for asserting a defense. Ultimately, the strength of the defense will depend upon the ability to show that the virus or its effects have made it impossible to perform.