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Covenants vs. Conditions in Construction Contracts

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It is sometimes overlooked that clauses in contracts requiring performance are not treated the same in cases of breach. There is a distinct difference in construction contracts between clauses that are conditions and clauses that are covenants. This difference determines the remedy a party is entitled to receive upon breach of the obligation. To understand this difference, we must first identify how these clauses are defined.

- "A **covenant** is a *promise to do something* (as in a covenant of quiet enjoyment in a deed)"; whereas,
- "[a] **condition** is a *contingency that must be met*, otherwise a particular property right could be gained or lost."[1]

Under generally accepted principles of contract law, the remedies for breaches of covenants and conditions are different. The remedies are as follows:

- For a breach of a **condition**, the breaching party is *not entitled to performance* (*i.e.*, payment) by the nonbreaching party.[2]
- For breach of a **covenant**, the breaching party is entitled to the nonbreaching party's performance; however, the nonbreaching party is entitled to be compensated for *damages resulting from the breach* of the covenant.[3]

The classic law school case *Jacob & Youngs, Inc. v. Kent*[4] provides a good analysis of the distinction. After the completion of a home construction project, it was discovered that the home was constructed with nonconforming pipe. The owner demanded replacement of the pipe, notwithstanding the fact that there was no evidence that the nonconforming pipe was inferior in quality to the pipe specified in the contract. Judge Cardozo, who authored the majority opinion of the court, discussed the distinction between covenants and conditions (sometimes referring to covenants as "dependent promises"). He stated:

There will be harshness sometimes and oppression in the implication of a condition when the thing upon which labor has been expended is incapable of surrender because united to the land, and equity and reason in the implication of a like condition when the subject matter, if defective, is in shape to be returned. From the conclusion that promises may not be treated as dependent to the extent of their uttermost minutiae without a sacrifice of justice, the progress is a short one to the conclusion that they may not be so treated without a perversion of intention. . . . There will be no assumption of a purpose to visit venial faults with oppressive retribution.[5]

The court held that the failure to use the specified pipe was the breach of a covenant rather than a condition. Thus, the owner was not excused from paying for the work (*i.e.*, "oppressive retribution"), but the payment could

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be reduced to reflect any reduction in value because of the use of the nonspecified pipe.

Due the harsh difference in remedies as noted by Judge Cardoza, conditions are often interpreted as covenants to avoid forfeiture — the surrendering of the right to receive payment over "venial faults." Since failure to satisfy a condition would prevent a contractor from recovering for work that it performed under the contract, courts may prefer to treat contractual obligations as covenants rather than conditions.[6] This is particularly true when a benefit has been conferred on the owner and nonpayment would be considered inequitable and akin to a forfeiture. As a generally accepted maxim of jurisprudence, equity abhors a forfeiture:

Forfeitures are not favored by the courts, and if an agreement can be reasonably interpreted so as to avoid a forfeiture, it is the duty of the court to avoid it. The burden is upon the party claiming a forfeiture to show that such was the unmistakable intention of the instrument. "A contract is not to be construed to provide a forfeiture unless no other interpretation is reasonably possible."[7]

A common area where conditions are interpreted as covenants are notice provisions. In California, for instance, notice provisions in contracts can be interpreted as covenants rather than conditions to avoid forfeiture of a contractor's claim.[8] When the notice requirement is found to be a covenant, the owner is entitled to recover, as an offset against the contractor's claim, whatever damages the owner actually suffered from not receiving timely notice.[9]

The policy behind treating conditions as covenants is to interpret the contracting parties' intentions to avoid unusual or inequitable results, to avoid forfeitures, and to avoid placing one party at the mercy of the other.[10] Courts have found that a provision in a contract for forfeiture of any damages for noncompliance with provisions relating to the filing of the claims must be strictly construed against that entity for whose benefit the clause was inserted.[11]

For example, in *D. A. Parrish & Sons v. County Sanitation District*,[12] the contract required written notice of a claim within 10 days after discovering the factual basis for the claim, and it provided: "The Contractor's failure to notify the Owner within such ten (10) day period shall be deemed a waiver and relinquishment of any such claim against the Owner." In refusing to enforce this forfeiture, the court held, "[A] forfeiture clause, such as this, will not only be strictly construed but has been interpreted by this court not to apply to claims arising from breaches of the contract caused by the other party."

Outside of California, other jurisdictions also interpret notice provisions to avoid forfeiture. Sometimes courts will find that the government entity received "constructive notice," thereby satisfying the notice condition in the contract. For example, in *Welding, Inc. v. Bland County Service Authority*,[13] a court found that mention of the claim issues in the progress meeting minutes was found to satisfy the notice requirement. Also, some courts will find that the notice would serve no useful function in the context of the case and therefore would not be considered a condition of the contract.[14]

There are some jurisdictions, however, that will not treat conditions as covenants in an effort to avoid forfeiture. For example, *Stone Forest Industries, Inc. v. United States*[15] involved a dispute arising out of contracts entered into with the U.S. Forest Service. Each of the contracts contained a provision stating that the purchaser shall file claims against the U.S. Forest Service within certain time limits and that "[f]ailure by Purchaser to submit a claim

within these time limits shall relinquish the United States from any and all obligations whatsoever arising under said contract or portions thereof."[16] The court held that this was "clearly a condition" because "the time limitation is clearly 'an event, not certain to occur, which must occur . . . before performance under a contract becomes due.'"[17] Additionally, the court held that the time limitation "is not a covenant, as plaintiffs argue, because it does not create a right or duty in and of itself."[18] The court found that, because the time limitation provision was a condition, and not a covenant, compliance with the time limitation was required before plaintiffs could enforce their refund rights under the contract.

Thus, due to the distinct differences in remedies in breaches of conditions and covenants, provisions in contracts that might be construed as conditions requiring forfeiture should be examined closely with an eye to the law of the contract's jurisdiction and any equitable principles that may cause courts discomfort in enforcing.

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1 John Reily, *Covenants vs. Conditions*, The Data Advocate (July 25, 2014).

2 *See* Thomas C. Horne, *Arizona Construction Law* § 102 (2020).

3 *Id*.

4 *Jacob & Youngs v. Kent*, 230 N.Y. 239, 242 (1921).

5 *Id*.

6 *See* Thomas C. Horne, *Arizona Construction Law* § 102 (2020).

7 *Universal Sales Corp., Ltd. v. California Press Mfg. Co.*, 128 P.2d 665, 677 (Cal. 1942).

8 *See* Cal. Civ. Code §§ 1442, 1670.5 (2020); Restatement (Second) Contracts § 227 (Am. Law Inst. 1981).

9 *E.g., Streicher v. Heimburge*, 272 P. 290, 294 (Cal. 1928) ("Many cases may be found where the words 'provided' or even 'on condition that' have been used and nevertheless held to be covenants and not conditions.").

10 *See* Cal. Civ. Code §§ 3542 & 3520; *Hawley v. Orange County Flood etc. Dist*., 211 Cal. Rptr. 478, 480 (Cal. Ct. App. 1963).

11 *See Milovich v. Los Angeles*, 108 P.2d 960, 965 (Cal. Ct. App. 1941).

12 *See D. A. Parrish & Sons v. Cty. Sanitation Dist*., 344 P.2d 883, 887 (Cal. Ct. App. 1959).

13 *See Welding, Inc. v. Bland Cty. Serv. Auth.*, 541 S.E.2d 909, 915 (Va. 2001).

14 *Sunshine Steak, Salad & Seafood, Inc. v. W. I. M. Realty, Inc*. 522 N.Y.S.2d 292, 293 (N.Y. 1987) ("[W]here it becomes clear that one party will not live up to a contract, the aggrieved party is relieved from the performance of futile acts or conditions precedent.").

15 *See Stone Forest Industries, Inc. v. U.S.*, 26 Cl. Ct. 410, 414 (1992).

16 *Id*. at 412.

17 *Id*. at 416-417.

18 *Id.* at 417.

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