Impact of "No Damage for Delay" Clauses on Surety Exposure and Contractor Claims

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Introduction

Both contractors and their sureties are presently faced with significant exposure relating to "no damage for delay" clauses contained in the bonded contract. To the extent that these clauses arguably place the bonded contractor in a position where there may be protracted delays under circumstances where the owner only intends to provide time extensions rather than delay damages, significant exposure exists not only to the contractor, but its surety. This paper will address those concerns and provide suggestions to aid both the bonded contractor and its surety in seeking fair and reasonable compensation for project delays.

I. The "No Damage for Delay" Clause From the Bonded Contractor's Perspective

One of the costliest events that can happen on a construction project is delay. Not only might delays prevent the scheduled completion date from being met, delays can also inflict monetary harm and damages upon the project participants. Because the scope of a contractor's possible damages caused by a delay are unpredictable and potentially very significant, owners frequently attempt to limit their potential exposure for delays on a project. One means of accomplishing this is the "no damage for delay" clause. Generally speaking, the "no damage for delay" clause seeks to limit a contractor's recovery for otherwise compensable delays to a time extension. However, a contractor damaged by delay and faced with such a clause under some circumstances may not be prohibited from recovering monetary damages. Indeed, multiple exceptions to the enforceability of a "no damage for delay" clause have been recognized in most jurisdictions throughout the United States. The enforceability of these clauses and the application of the exceptions are frequently litigated by construction participants. Although

myriad fact patterns and results emerge, the pervasive theme underlying the exceptions is that one party (i.e., the owner) seeks to enforce a provision enacted for its benefit despite the fact that it has materially breached the contract.

The generally recognized exceptions to the enforceability of the "no damage for delay" clause are as follows:

a. Where the delay is caused by the bad faith of the party seeking to enforce the provision (i.e. usually the owner);

b. Where the delay is so extensive in duration that it amounts to an abandonment of the contract;

c. Where the delay is of a type not contemplated by the parties at the time of entering into the contract; and

d. Where the delay is created by the active interference of the party seeking to enforce the provision.

When "no damage for delay" clauses are litigated, it is important to remember that the clauses are exculpatory clauses (i.e. clauses where a contracting party seeks to shield itself from liability due to its own fault). As such, the clauses are usually strictly construed against the drafting party (again, usually the owner). Most, if not all, of the exceptions are premised upon the concepts of fairness and/or equity. Because of the harsh effects of a "no damage for delay" clause, courts often carefully consider the underlying facts giving rise to the delay. For example, it is illogical to believe that an owner who has (a) included a "no damage for delay" clause in its contract, (b) directed the contractor to begin work on a certain date, and (c) then prevented the contractor from having access to the site, could rely upon the presence of the "no damage for delay" clause to avoid liability for the contractor's damages resulting from the delay. This flies in the face of our notions and expectations of fundamental fairness. Although this may be an extreme example, in such a case the court is unlikely to enforce the "no damage for delay" clause.

A. Legislative Prohibitions

Before we turn our attention to the specific exceptions to enforceability that are set forth above, it should be pointed out that some state legislatures prohibit the enforceability of "no damage for delay" clauses in certain instances. (*See*, e.g., Cal. Pub. Con. Code § 7102—invalidates no-damage-for-delay clauses in public works contracts); (Colo. Rev. St. § 24-91-103.5—no-damage-for-delay clauses are void as against public policy in public works contracts); (La. Civ. Code Ann. Art. 2004—a contractual clause that "in advance, excludes or limits the liability of one party for intentional or gross fault that causes damage to the other party" is nullified.); (V.A.M.S. ((Mo.)) § 34.058.2—No-damages-for-delay clauses are not permissible in public works contracts.); (N.J.S.A. 2A:58B-3—a public contract which seeks to preclude a contractor's claim for damages caused by the public entity's bad faith, active interference, or other tortious conduct is void and unenforceable); (Ohio Rev. Code § 4113.62—no-damages-for-delay clauses void and unenforceable as against public policy "when the cause of the delay is a proximate result of the owner's act or failure to act"); (Oreg. Rev. St. § 279C.315—any clause in a public improvement contract that purports to waive, release or extinguish the rights of a contractor to damages or an equitable adjustment arising out of unreasonable delay in performing the contract, if the delay is caused by acts or omissions of the contracting agency or persons acting therefore, is against public policy and is void and unenforceable); (Va. Code Ann. § 2.2-4335—any provision contained in any public construction contract that purports to waive, release, or extinguish the rights of a contractor to recover costs or damages for unreasonable delay in performing such contract, either on his behalf or on behalf of his subcontractor if and to the extent the delay is caused by acts or omissions of the public body, its agents or employees and due to causes within their control shall be void and unenforceable as against public policy);

and (RCCJA ((Wash.)) 4.24.360—any clause in a construction contract, which purports to waive, release, or extinguish the rights of a contractor to damages or an equitable adjustment arising out of unreasonable delay in performance which delay is caused by the acts or omissions of the contractee or persons acting for the contractee is against public policy and is void and unenforceable). Note however the common thread in these states that statutorily prohibit "no damage for delay" clauses. Specifically, these prohibitions apply solely to public works contracts. Presumably, parties to a private contract in these jurisdictions are authorized to include "no damage for delay" clauses in their contracts. A contractor damaged by delay and facing the potential harshness of such a clause in those instances must look to the recognized exceptions to defeat enforcement.

B. The Exceptions

1. Delay Caused by Bad Faith of the Party Seeking to Enforce the Provision

Most, if not all, jurisdictions impose an obligation on all contracting parties to not hinder or impede the other party's performance. Even where such a duty is not expressly written into the contract, it will be considered an implied duty binding all of the contracting parties. Along with the "active interference" exception discussed below, the "bad faith" exception is premised upon this implied duty of good faith and fair dealing. Bad faith will generally be found where the owner's misconduct is willful, wanton and carried out with intent. *See* 74 A.L.R. 3d 187 (collecting cases from across the United States).

Although an actual fraud perpetrated by the owner on the contractor would clearly justify a finding of bad faith sufficient to overcome the enforcement of a "no damage for delay" clause, the owner's actions do not *always* need to rise to such a serious level in some states. For example, an owner's "refusal to grant extensions on a timely basis [could] reasonably be

interpreted as ... bad faith [to] justify a damages award." *Mississippi Transp. Comm'n v. SCI, Inc.*, 717 So.2d 332, 338 (Miss. 1998). In addition to Mississippi, the following jurisdictions recognize the "bad faith" exception: *RaCON, Inc. v. Tuscaloosa County*, 953 So. 2d 321, 339 (Ala. 2006); *W.C. James, Inc. v. Phillips Petroleum Co.*, 347 F. Supp. 381, 385 (D. Colo. 1972); *White Oak Corp. v. DOT*, 217 Conn. 281, 288 (Conn. 1991); *F. D. Rich Co. v. Wilmington Housing Authority*, 392 F.2d 841, 843-45 (3d Cir. Del. 1968); *Blake Constr. Co., Inc. v. C.J. Coakley Co.*, 431 A.2d 569, 578-79 (D.C. 1980); *Triple R Paving, Inc. v. Broward County*, 774 So. 2d 50, 54-56 (Fla. Ct. App. 2000); *Ragan Ent. v. L&B Const. Co., Inc.*, 492 S.E.2d 671 (Ga. Ct. App. 1997); *Bates & Rogers Construction Co. v. Greeley & Hansen*, 486 N.E.2d 902 (Ill. 1985); *Peter Kiewit Son's Co. v. Iowa Southern Utilities Co.*, 355 F. Supp. 376 (D.C. Iowa 1973); *State Highway Admin. v. Greiner Eng'g Sciences, Inc.*, 577 A.2d 363 (Md. Ct. Spec. App.); *Phoenix Contractors, Inc. v. General Motors Corp.*, 355 N.W.2d 673 (Mich. Ct. App. 1984); *Siefford v. Housing Authority of Humbolt*, 223 N.W.2d 816, 823 (Neb. 1974); *J.A. Jones Constr. Co. v. Lehrer McGovern Bovis, Inc.*, 120 Nev. 277, 286 (Nev. 2004); *Corinno Civetta Const. Corp. v. New York*, 67 N.Y.2d 297 (N.Y. 1986); *Psaty & Fuhrman, Inc. v. The Housing Authority of the City of Providence*, 76 R.I. 87 (1949); *Williams Electric Co., Inc. v. Metric Constructors, Inc.*, 325 S.C. 129 (1997) (answering a certified question of what exceptions South Carolina would recognize); *Thomas & Associates, Inc. v. The Metropolitan Government of Nashville and Davidson County*, No. M2001-00757-COA-R3-CV, 2003 Tenn. App. LEXIS 425 (Tenn. Ct. App. June 6, 2003); *Jensen Const. Co. v. Dallas County*, 920 S.W.2d 761 (Tex. Ct. App. 1996); and *Nelson v. City of Eau Claire*, 175 Wis. 387 (1921).

2. Delay So Extensive in Duration that it Amounts to Abandonment

Of all the exceptions applied in the various jurisdictions, the "abandonment" exception is undoubtedly the most fact-sensitive and difficult to predict. Because courts allow parties to freely contract and bargain for certain rights and the allocation of risk, no bright line rule emerges that defines a delay of a certain length of time as being one which is so extensive in duration to constitute abandonment.

As the court in *Corinno Civetta Constr. Co. v. City of New York*, 493 N.E.2d 905, 912 (N.Y. 1986) stated, "[T]he contractee is responsible for delays [notwithstanding a "no damage for delay" clause] which are so unreasonable that they connote a relinquishment of the contract by the contractee with the intention of never resuming it." Indeed, contractors working in the current economy may see such a scenario play out with increasing frequency. Owners faced with a lack of capital and undergoing a financial hardship are more inclined to indefinitely suspend performance. In those cases where the contractor can demonstrate that the owner has a minimal chance of (or lack of intention to) resume the project at a later time, abandonment may more easily be proven.

Another example of abandonment of the contract exists where the contractor can demonstrate that a cardinal change has taken place. A cardinal change is one which fundamentally alters the scope of the original contract. If an owner directs a change that materially alters the work that the parties bargained for when the contract was initially executed, a cardinal change exists. In such a case, the parties initial contractual undertaking can be argued to have been abandoned, thus nullifying the application of an otherwise valid "no damages for delay" clause.

Abandonment via a cardinal change or an indefinite or permanent suspension of the work is easier for the contractor to prove than abandonment based solely upon the length of the delay. The reported cases from across the country demonstrate this unpredictability. (*Compare*, e.g. *White Oak Corp. v. DOT*, 217 Conn. 281, 288 (Conn. 1991) (recognizing exception but holding that on project that took 67 months, 6 months or less was not unreasonable delay), *Space Structures International Corp. v. George Hyman Construction Co.*, 1989 U.S. Dist. LEXIS 5798, at *46-*47 (D.D.C. 1989) (recognizing exception but holding that six and one-half months to complete was not unreasonable when original schedule was for two and one-half months) and *Commercial Elec. Contrs., Inc. v. Pavarini Constr. Co., Inc.*, 2008 NY Slip Op 3064, 2 (N.Y. App. Div. 1st Dep't 2008) (a delay of 8 to 20 months was not enough to constitute abandonment given the facts of the case) with *E.C. Nolan Co. v. State*, 227 N.W.2d 323 (Ct. App. 1975) (delay of nine and one-half months on project was unreasonable where total contract construction period was only 24 months); *Abax Inc. v. N.Y. City Hous. Auth.*, 723 N.Y.S.2d 490 (N.Y. App. Div. 1st Dep't 2001) (a delay of 600 days is sufficiently indicative of abandonment);; *Bovis Lend Lease LMB, Inc. v. GCT Venture, Inc.*, 6 A.D.3d 228, 229 (N.Y. App. Div. 1st Dep't 2004) (a 2.5 year delay is so unreasonable as to at least create a triable issue of fact).

3. Delays Not Contemplated by the Parties at the Time of Contracting

The application of this exception requires the fact finder to essentially step back in time to determine the intentions of the parties at the time the contract was initially executed in order to conclude whether a given cause for the delay was anticipated, considered or contemplated. Of all of the recognized exceptions to the "no damage for delay" clause, this exception seems to have met with the most resistance. Indeed, "[t]he question of whether the 'not contemplated' exception should even be recognized is in hot debate throughout the United States." *Bruner &*

O'Connor on Construction Law, Vol. 5, §15:79, p. 229 (2002). The tension in applying this exception stems from the court's willingness to allow the parties freedom to contract on the one hand, and its requirement that the parties document with specificity the potential causes for a delay on the other hand. Therefore, an owner relying upon a clause similar to the following: "the contractor expressly waives its right to recover for damages for delay *regardless of the cause of the delay*" may have difficulty enforcing the provision later. Conversely, a "no damage for delay" clause that specifically enumerates potential causes for delay (e.g. certain weather events, a lack of site access, unavailability of materials, or delays caused by the failure to complete predecessor activities) may be more likely to be upheld if the actual project delay results from that identified cause.

In addition to analyzing the specificity of the clause, courts also may look to the foreseeability of certain delays in determining whether to enforce the clause. Although it may be somewhat more difficult for a contractor to successfully argue this exception as compared to the others, it is nevertheless recognized and applied in some jurisdictions. See, e.g. *Creedon Controls, Inc. v. Banc One Bldg. Corp.*, 470 F. Supp. 2d 457, 462 (D. Del. 2007) (act of God not contemplated); *Interior/Exterior Specialist Company v. Devon Industrial Group, LLC*, 2009 Mich. App. LEXIS 299, *6 (Mich. Ct. App. 2009) (noting that the evidence supported plaintiff's claim that delay and costs incurred by contractor when it was forced to work in muddy conditions and without the proper heat, power and equipment exceeded what either party anticipated at the time of contracting).

4. Active Interference

Some jurisdictions apply or explain this exception in conjunction with the "bad faith" exception. Although bad faith, fraud, or willful and wanton misconduct by an owner no doubt

constitutes "active interference", such a finding is not necessarily required in all jurisdictions for the exception to apply. Indeed, this exception also may be stated “in terms otherwise constituting a breach of the implied obligations of cooperation and nonhindrance.” *Bruner & O'Connor on Construction Law*, Vol. 5, §15:77, p. 223 (2002), citing *Harry Pepper & Assoc., Inc. v. Hardrives Co., Inc.*, 528 So.2d 72, 74 (Fla. Ct. App. 1988) (where a party contracts for another to do a certain thing, he thereby impliedly promises that he will himself do nothing to hinder or obstruct the other from doing the agreed thing). Furthermore, an owner’s negligence in failing to take the reasonable steps necessary to acquire a rights-of-way was sufficient to invoke the “active interference” exception in *Southern Gulf Util., Inc. v. Boca Ciega Sanitary Dist.*, 238 So.2d 458 (Fla. Ct. App. 1970).

The following cases reflect other instances where the court has applied this exception and prohibited an owner from enforcing the "no damage for delay" clause: *Triple R Paving, Inc. v. Broward County*, 774 So. 2d 50, 54-56 (Fla. Dist. Ct. App. 2000) (failure to participate in the other party's performance and knowledge of a plan defect and failure to apprise the other party of the problem); *Newberry Square Dev. Corp. v. Southern Landmark, Inc.*, 578 So. 2d 750, 752 (Fla. Dist. Ct. App. 1991) (includes delays associated with providing approved plans and specifications, delays in executing change orders, and failure to make timely payments); *Grant Construction Co. v. Burns*, 443 P.2d 1005, 1005 (Idaho 1968) (owner failed to remove utility poles, which hindered construction); *Plato Gen. Constr. Corp./Emco Tech Constr. Corp., JV. LLC v. Dormitory Auth. of the State of New York*, 2008 NY Slip Op 52416U, 7 (N.Y. Sup. Ct. 2008) (delays resulting from the owner's breach of a fundamental obligation of the contract are an exception to the “no damages for delay” rule); and *Coatesville Contractors & Engineers, Inc.*

v. Borough of Ridley Park, 509 Pa. 553 (1986) (recognized as an exception and found this exception satisfied where owner did not drain lake as required by the contract).

In those jurisdictions where the contractor need not prove some willful "bad act" by the owner to invoke the "active interference" exception, an interesting argument may arise based upon the interplay between an owner's implied warranty of the adequacy of the plans and specifications and the delay. Most, if not all, jurisdictions in the United States recognize the *Spearin* doctrine. Specifically, the doctrine holds that when a contractor follows the plans and specifications furnished by the owner, and those plans and specifications turn out to be defective, the contractor is not liable to the owner for any loss or damage resulting from the defective plans and specifications. A natural corollary to the doctrine arises if those defective plans and specifications also result in project delays (e.g. through the issuance of, and responding to, numerous Requests for Information or project re-designs). In such a case, the contractor has a convincing argument that the owner's breach of the warranty of the adequacy of those plans and specifications constitutes "active interference", which should preclude an owner from also relying upon a "no damage for delay" clause as a means of insulating itself from liability for delay. *See,* e.g., *Plato Gen. Constr. Corp. v. Dormitory Auth. of the State of New York*, 2010 NY Slip Op 50916U, *5 (N.Y. Sup. Ct. 2010) (contractor entitled to delay damages, despite the existence of a "no damage for delay" clause, where among other things the owner supplied defective plans to a contractor resulting in a complete re-design of the HVAC system at the facility).

C. Practical Pointers

Unfortunately, contractors are often placed in the unenviable position of being forced to accept an owner's one-sided contract terms and get the work, or resist those terms and lose the

opportunity to perform. The "no damage for delay" clause is but one example of such a one-sided term. Contractors are well-advised to seek the removal of the clause altogether. However, if that is unsuccessful or impractical, the contractor can take certain precautions to potentially lessen the harsh impact of the clause. *First*, the contractor might request that the owner specifically identify the types of delays contemplated *at the time of contracting*. A delay based upon some cause that is not specifically identified may open the door to a successful challenge based upon the "beyond contemplation" exception. *Second*, the contractor should ask that a mutual waiver of consequential damages be included. If the contractor is potentially forfeiting the right to recover significant delay or impact damages based upon an extended (or compressed) schedule, the owner similarly should be asked to walk away from potentially significant consequential damages (e.g. lost profits resulting from a delay in completion). *Third*, contractors facing a "no damage for delay" clause *must* include a similar clause in its subcontracts and supplier agreements. The contractor faces an extreme financial burden if it is unable to seek delay damages from the owner on the front-end, but is exposed to delay damages from any of its subcontractors on the back end. Of course, bear in mind that even the inclusion of a "no damage for delay" clause in a subcontract does not end the analysis, as the subcontractor also may rely upon the exceptions that are the focus of this paper in any claim against the general contractor.

II. The “No Damage for Delay” Clause From a Surety’s Perspective

In this economic climate, bonded contractors are frequently presented with contracts which contain a “no damage for delay” clause. Clauses of that type also impact the surety which issues a performance bond or payment bond for projects where the bonded contractor is subject to a “no damage for delay” clause. Under some circumstances, the bonded contractor may be subject to protracted delays of many months and on occasion more than a year. Under those

circumstances, contractors are faced with a far different project than was anticipated when the initial bid documents were submitted and when the surety agreed to bond the project in question.

Protracted delays directly impact a contractor's ability to complete a project and move on to other projects in a timely fashion. A contractor may be subject to delays of unknown durations which create unplanned and extended field office overhead expenses. A contractor may be without sufficient information needed to ascertain whether or not it can demobilize and move equipment from a delayed project for use at another location. Delays of this type can often create very serious cash flow problems for contractors who may be confronted with unknown delays for extended periods of time. To the extent that the owner maintains that the contractor is only entitled to a time extension rather than an equitable reimbursement for delay damages, the contractor has serious exposure. Under these circumstances, the contractor's surety will likely be placed on notice and thereafter be drawn into this controversy.

A. Payment Bond Issues

Depending upon the size and magnitude of the bonded project, a surety's bond principal may be subject to cash flow problems which impact the contractor's ability to timely pay subcontractors and suppliers. Problems of this type may lead to claims being directly made upon the surety by unpaid claimants pursuant to the payment bond. Under those circumstances, the surety's claim department will become involved and will then review payment bond claims. Sureties become uncomfortable very quickly when a number of payment bond claims are submitted on projects where the owner is refusing to reimburse the bonded contractor for extended delays. A file is opened for each claim and the validity of each claim is reviewed by the surety's claim department. Surety claim personnel will investigate payment bond claims both as to validity and amount.

Payment bond claims will also promptly generate a review by the surety of its General Agreement of Indemnity or other security agreement executed by the bonded contractor and perhaps personal indemnitors. The surety may elect to make a formal demand upon bond indemnitors (both personal and corporate) and may even request that collateral be provided for the surety's further protection.

The surety will initiate procedures to undertake an independent investigation of the status of the construction project. To the extent that the owner is maintaining that a "no damage for delay" clause precludes an equitable reimbursement to the contractor for delay damages, the surety will undertake its own investigation to ascertain the validity of the owner's position. The surety may also be involved in ascertaining whether or not any of the nationally recognized exceptions to the "no damage for delay" clause at issue may be applicable under the circumstances.

On private projects where owners argue that a "no damage for delay" clause precludes reimbursement to the contractor for delay damages, it is also possible that mechanic's liens may be filed by unpaid subcontractors and suppliers. That action may trigger a demand from the project owner to either satisfy the mechanic's liens or perhaps "bond over" the liens. Depending upon the jurisdictions, the unpaid subcontractors and suppliers may present "owner notification letters" or "stop payment letters" advising the appropriate party that the subcontractor or supplier is not being paid in a timely fashion. Claims of this type may further impact the bonded contractor's ability to receive payment. To the extent that payment issues worsen, the surety's exposure increases accordingly.

B. Performance Bond Issues

To the extent that the owner maintains that the bonded contractor is not entitled to equitable reimbursement for delay damages, that action may place the contractor in such a severe financial position that the contractor is unable to timely proceed with construction. There would also be the potential that the bonded contractor simply would be unable to proceed further which may then lead to a contract termination or bond default.

Actions of that type may generate a claim against the surety based upon the surety's performance bond obligations. Once again, the surety will undertake its own independent investigation to ascertain whether or not the owner is justified in withholding payments to the bonded contractor. That review will also ascertain whether or not any of the nationally recognized exceptions to the "no damage for delay" clause may support the contractor being reimbursed for delay damages. The surety's claim personnel may request a meeting with representatives of the owner and contractor to address the application of the "no damage for delay" clause and hopefully generate a scenario where funds will be released to allow timely completion of construction activity.

Ironically, an owner's inappropriate reliance upon a "no damage for delay" clause may in fact trigger financial problems on the owner's own construction project. If an owner takes the position that the contractor may be subject to extended delays without monetary compensation of any kind, by taking that position, the contractor may be denied sufficient financial resources to proceed with the project. The surety would then be confronted with not only payment bond claims, but likely a performance bond claim.

The surety's underwriting department will also become involved because it will be notified by the surety's claim department that payment bond claims and/or a performance bond

claim have been received. The surety's underwriting department may consider reduced bonding capacity should there be a sufficient concern that the bonded contractor would not have the overall financial capacity and capability of weathering the financial storm arising from the project where the contractor is encountering significant delays without any reimbursement from the owner. The surety's underwriting department may be less inclined to issue new bonds until the financial picture becomes clearer. The surety may also be concerned if its bonded contractor begins to drain funds from other bonded projects in an effort to proceed with construction on the "no damage for delay" project where additional expenses are being incurred under circumstances where the owner refuses any reimbursement of delay damages. Most sureties would be very concerned if funds were being drained from other bonded projects which might create a "domino effect" of default.

III. Conclusion

In the present economic climate where many bonded contractors are already struggling with negative factors such as fewer projects which are bid under extremely competitive circumstances, it becomes more important how a contractor addresses a "no damage for delay" situation. For the reasons noted in this paper, contractors may be entitled to compensation under one or more of the nationally recognized exceptions to the "no damage for delay" clause. A "no damage for delay" clause also impacts the exposure of the contractor's surety both for performance bond liability and payment bond exposure. As is usually the case, both the contractor and its surety will benefit if there is a prompt exchange of information prior to the financial condition of the contractor reaching a "critical stage." It is important that the contractor provide necessary information to the surety as soon as reasonably possible so that the surety can evaluate its position and bond exposure. Under most circumstances, both the contractor and its

surety will benefit from a coordinated approach on projects where the owner is taking an unreasonable position concerning application of a “no damage for delay” clause.