



What Do You Mean I'm Not Entitled to Recover My Damages – The Ramifications of Clauses that Limit Liability in Construction Contracts

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Most Common Contractual Clauses for Limiting Liability

- 1) **No Damages for Delay Clause**
 - Waives the contractor's right to recover damages for delay.

- 2) **Waiver of Consequential Damages**
 - Waives the recovery of consequential damages.

- 3) **Liquidated Damages Clause**
 - Stipulates the amount of damages in advance of any breach.

Motivation Behind Limitation of Liability Clauses

- **Owners and General Contractors attempt to control their risks because:**
 - 1) **the different types and amounts of damages to which they are entitled are hard to predict;**
 - 2) **these damages are often hard to quantify; and**
 - 3) **these limitations on damages enable the parties to regain a sense of certainty and predictability.**

Damages for Delay

- **The General Rule for Recovering Delay Damages:**
 - **A contractor is entitled to recover damages for losses due to delay in the performance of its work if the contractor proves:**
 - 1) **its work was delayed or hindered;**
 - 2) **it suffered damages because of the delay or hindrance;**
and
 - 3) **the owner of the project was responsible for the act or omission which caused the delay or hindrance.**

No Damage for Delay Clauses

- **Purpose**
 - To prevent contractors from recovering any damages for delay.
- **Effect**
 - Shifts risk of delay from the Owner to the Contractor.

O'Conner v. Smith (1892)

- **Facts:**
 - The construction contract between the owner and the contractor contained the following provision:
 - In case the company shall be delayed in acquiring title to the lands required by the [owner], or for any other reason, the contractor shall not be entitled to any damages . . . but shall have such extension of time for the completion . . . as the engineer may deem proper.
 - The contractor sued the owner for damages caused by the owner's delays.
- **Holding:**
 - The court ultimately found that the provision did not apply under the circumstances because it only limited damages for delays that the owner could have experienced and did not expressly limit damages for delays the owner could have caused.
- **Importance of *O'Conner*:**
 - While the court in *O'Conner* ultimately found the “no damage for delay” provision inapplicable, the Court's reference to it is helpful to note how courts view these clauses.

Five Exceptions

- **Can Prevent Enforcement of a No Damage for Delay Provision:**
 - 1) **Delay was caused by fraud, misrepresentation or bad faith;**
 - 2) **Delay was not contemplated by the parties;**
 - 3) **Delay was extended for an unreasonable length of time;**
 - 4) **Delay was not in the specifically enumerated delays to which the clause applies; or**
 - 5) **Delay was caused by active interference of the Owner or other wrongful conduct.**

(1) Delay Caused by Fraud, Misrepresentation, or Bad Faith

- Where the delay results from “arbitrary and capricious” conduct on the part of the Owner or its agents, and implies bad faith on the part of the Owner, a court will likely find the no damage for delay provision unenforceable .
- *Housing Authority of City of Dallas* (1959)
 - Facts:
 - When the owner tried to limit the contractors’ delay damages through the use of the provision, the contractors successfully argued that the delay was caused by the owner’s architect, who forced the contractors to follow “arbitrary and capricious requirements” during the construction, and thus, fell outside the protection of the “no damage for delay” provision.
 - Example of “Arbitrary and Capricious” Requirements:
 - The architect continually refused to accept the paint job because first he wanted more texture and then he did not want so much texture.
 - Then, the architect suggested that there was no way to acquire a standard texture “unless [the painters] draw a circle and count those granules in there and let that be a sample.”
 - The architect then required a “wash test,” which was not a requirement in the original specifications.
 - After the first wash test, the architect required a letter, stating it would not cost the owner any more money to put on two coats of paint.
 - Then the architect required another “wash test” on the paint, but this time, required the paint soak overnight.
 - Once the painters finally began painting the buildings, the painters were continually asked to “Do this apartment over.”

(2) Delay Not Contemplated by the Parties

- If the delay was not something reasonably contemplated by the parties at the time of contracting, the Owner cannot enforce the “no damage for delay” provision.
- *City of Dallas* (1935)
 - Facts:
 - City entered into a contract with Contractor to build a tunnel through a hill to divert certain waters into a creek.
 - Shortly thereafter, Contractor began assembling materials, machinery and a number of skilled employees in preparation of building the tunnel.
 - Unbeknownst to Contractor, at the time the contract was entered into, the City had failed to secure the right of way which was necessary for the construction of the tunnel.
 - This failure led to an injunction, delaying the work for several weeks until the right of way was finally secured.
 - Held that the “no damage for delay” provision was unenforceable because, at the time of contracting, the parties did not intend or contemplate the type of delay that caused Contractor’s injury.

(3) Delay Extended for Unreasonable Length of Time

- Owner not likely to get to enforce its “no damage for delay” provision if the delay extended for such an unreasonable length of time that the party delayed would have been justified in abandoning the contract.
- *Jensen Construction* (1996)
 - Facts:
 - The contractor sued the County for breach of contract, after the County delayed the contractor’s completion of the drainage improvements.
 - In its answers to the interrogatories, the contractor “listed specific instances of unreasonable interference which delayed and reduced the efficiency of work on the project, and required suspension of work until the rules imposed by the County could be complied with.”
 - The owner filed a summary judgment, arguing that the “no damage for delay” provision conclusively precluded the contractor from recovering delay damages.
 - Held that the owner “failed to conclusively establish that the ‘no damage for delay provisions’ preclude[d] delay damages by the contractors in light of the fact issues concerning the owner’s bad faith and the unreasonable length in time for the delay.”

(4) Delay Not Within the Specifically Enumerated Delays

- If the Owner and the Contractor specifically identify certain delays to which the “no damage for delay” provision applies and the Contractor’s damages arise from a delay outside of these stipulated delays, the Owner will likely be precluded from enforcing its “no damage for delay” provision.
- For example:
 - A provision that states that an Owner will not be liable for damages on account of delays due to changes made by the Owner will likely not preclude the Contractor from recovering delay damages that result from other types of delays that are not “due to changes made by the Owner.”

(5) Delay Caused by Active Interference of Owner

- ***Alamo Community College (2004)***
 - **Facts:**
 - The Owner and the General Contractor entered into a contract for the construction of a new campus for the Owner.
 - After disagreements over delay, the General Contractor sued the Owner for breach of contract.
 - **Jury Question:**
 - "Were the delays encountered by [the General Contractor] on the Project caused by the active interferences by [the Owner] or its agents and/or Architects?"
 - The jury's answer of "yes" prevented the Owner from relying on its no-damages-for-delay clause.

Proving One of the Five Exceptions at Trial

- **Jury Questions**
 - Ask the jury to make findings that track the specific language of your exception.
 - *Solis* (1997)
 - Held that a jury question merely on the cause of delay will not likely be adequate enough to establish one of the five exceptions.

Drafting Tips

- ***Dresser* Fair Notice Requirements Do Not Apply**
- **Danger of Drafting Broadly-Worded Clauses**
 - *City of Beaumont v. Excavators & Constructors, Inc.* (1993)
- **Better Practice is to Specifically List Out:**
 - Types of Delay-Causing Events
 - Specific Damages the Parties are Attempting to Exclude

Drafting Tips

- **Use the Clauses as a Source of Leverage in Negotiating the Contract Price**
- **List Out All Five Exceptions in the Clause, for example:**

No payment or compensation of any kind shall be made to the contractor for damages because of hindrance or delay in the progress of the work, unless such delays are caused by the actual interference, fraud, bad faith or misrepresentation by the Owner or its agents or such delays extend for an unreasonable length of time or were not contemplated by the parties at the time of contracting.

Waiver of Consequential Damages

- **Purpose**

- To eliminate the uncertainty and unpredictability surrounding the awarding of consequential damages.

- **Example: ¶15.1.6 AIA Document A201 (2007)**

The Contractor and Owner waive claims against each other for consequential damages arising out of or relating to this Contract.

This mutual waiver includes:

- .1 damages incurred by the Owner for rental expenses, for losses of use, income, profit, financing, business and reputation, and for loss of management or employee productivity or of the services of such persons; and
- .2 damages incurred by the Contractor for principal office expenses including the compensation of personnel stationed there, for losses of financing, business and reputation, and for loss of profit except anticipated profit arising directly from the Work.

Enforcing the Waivers

- **Waivers are Enforceable Unless They Are Unconscionable**
- **In Determining if Unconscionable, a Court Must Examine:**
 - 1) **the entire atmosphere in which an agreement is formed;**
 - 2) **the alternatives available to the parties at the time of contracting;**
 - 3) **the lack of bargaining ability of one party;**
 - 4) **whether the contract is contrary to public policy or illegal; and**
 - 5) **whether the contract is oppressive or unreasonable.**

Enforcing the Waivers

- **No Construction Case in Texas Where Consequential Damages Waiver Deemed Unenforceable or Unconscionable.**

Interpretation: Is It Direct or Is It Consequential?

- *Arthur Anderson & Co. (1997)*
 - Direct Damages – “Flow naturally and necessarily from the wrong”
 - Consequential Damages – “Result naturally, but necessarily, from the defendant’s wrongful acts . . . must be foreseeable . . and must be directly traceable to the wrongful act and result from it.”

Interpretation: Confusion Reigns

- **Seemingly Identical Damages Have Been Held to Be Direct Damages in Some Cases and Consequential Damages in Other Cases**
- **For Example:**
 - **Courts Have Sometimes Considered Lost Profits Direct Damages and Other Times Consequential Damages**
 - *Tennessee Gas Pipeline* (2008)
 - *Cherokee County Cogeneration* (2009)

Tennessee Gas Pipeline

- **Facts:**
 - The owner contracted with the contractor to replace and upgrade six compressors.
 - The owner expected the work to be completed within seventeen months; however, the project was not completed until three years after commencement.
 - The owner sued for damages, including damages for project delay costs, loss of efficiency, extended power, backup generator rental, allowance for funds during construction, and premature energy costs.
 - The contractor argued that the claims alleged against it were actually claims for consequential damages, which were excluded under the contract.

Tennessee Gas Pipeline

- **Consequential Damages Waiver:**
 - ***Consequential Damages:*** Notwithstanding any other provisions of this Agreement to the contrary, in no event shall Owner or Contractor be liable to each other for any indirect, special, incidental or consequential loss of damage *including, but not limited to, loss of profits or revenue, loss of opportunity or use* incurred by either Party to the other, or like items of loss or damage; and each Party hereby releases the other Party therefrom.

Court's Holding Concerning Lost Profits

- Houston Court of Appeals recognized that the waiver itself was enforceable, but that it did “not preclude the recovery of direct damages involving loss of use, opportunity, or profits.”
- The court acknowledged that “[l]ost profits can take the form of direct or consequential damages.”
 - For example, if the profits are lost on the breached contract itself, then the profits are likely classified as direct damages.
 - But if a party’s expectation of profit is merely incidental to the performance of the contract, the loss profits are likely classified as consequential.
- Ultimately, the court held the lost profits were consequential and barred by the contract because the owner’s “expectation of profit through the sale of gas to its customers [was] incidental to the performance of [the owner’s] Contract with [the contractor] concerning the installation of new equipment.

Court's Holding Concerning Additional Damages

- When addressing the remaining damages alleged by the contractor, the court found the following:
 - Direct damages
 - Project delay costs
 - Damages arising from providing extended power
 - Consequential damages
 - Loss of efficiency
 - Cost of backup generator rental
 - Allowance for funds during construction
 - Premature energy costs

Cherokee County Cogeneration

- **Facts:**
 - The supplier and purchaser entered into a Gas Purchase Agreement, containing a consequential damages waiver.
 - After the supplier breached the contract, the purchaser sued, seeking damages for the market value of the gas not received.
 - The supplier argued that the purchaser was merely seeking consequential damages for any “lost profits” the purchaser might have realized by reselling gas to third parties at a higher market price, and thus, these damages were barred by the contract
- **Consequential Damages Waiver:**
 - The remed[y] specified in Section[] . . . 5.2 above shall be the sole and exclusive remed[y] for . . . Seller’s failure to deliver gas according to this Agreement. Neither party shall be liable in any event for consequential, incidental, special or punitive damages or losses which may be suffered by the other as a result of the failure to deliver . . . the required quantities of gas.

Drafting Tips

- **Spell Out Exactly What Types of Consequential Damages The Parties are Excluding**
- **Include a Waiver of Insurance Subrogation Rights**

Example of Consequential Damages Waiver

- The Owner waives, and will require its insurers to waive rights of subrogation with respect to, all liability for Owner's consequential, special, indirect or incidental damages arising out of or relating to this Contract. *In addition, the following damages, whether consequential, direct, or otherwise, are also waived:*
 - damages incurred by the Owner for rental expenses, for losses of use, loss of business opportunity, loss of product or output, income, loss of profit or revenue, cost of capital, financing, business and reputation, and for loss of management or employee productivity or of the services of such persons; and
- The Contractor waives all liability for Contractor's consequential, special, indirect or incidental damages arising out of or relating to this Contract. *In addition, the following damages, whether consequential, direct, or otherwise, are also waived:*
 - damages incurred by the Contractor for principal office expenses including the compensation of personnel stationed there, for losses of financing, business and reputation, and for loss of profit except anticipated profit arising directly from the Work.

Liquidated Damages Provisions

- **Purpose**
 - Allows the parties to agree in advance upon an amount of damages for breach.
- **Benefits**
 - Implications are known early on by both parties
 - Alleviates the need for the nonbreaching party to prove actual damages

No Penalties Allowed

- **Provision cannot be used as a “penalty”**
- **The Two Part Test**
 - 1) **the harm caused by the breach is incapable or difficult of estimation, and**
 - 2) **the amount of liquidated damages is a reasonable forecast of just compensation**

Applying the Two Part Test

- **Determining the “Reasonableness”**
 - Examine the ratio between the liquidated damages and the actual loss, as well as the nature of the breach that triggers the provision
- **Can’t Be Disproportionate**
 - If the liquidated damages are shown to be disproportionate to the actual damages, then the liquidated damages must be declared a penalty and recovery limited to the actual damages proven

Enforceable Liquidated Damage Clause or Penalty?

Examples in the construction context:

- *Loggins* (1976)
- *Advance Tank* (1990)

Unenforceable as a Matter of Law

- A liquidated damages provision is a penalty if it applies equally to any breach of any provision of the contract irrespective of the importance or triviality of such breach
- *Bethel* (1982)

Proving the Enforceability of the Provision at Trial

- Question of Law
- Burden of Proof on Party Arguing the Liquidated Damages Clause is a Penalty
- Must Assert “Defense of Penalty” as an Affirmative Defense
 - Unless the defense of penalty is apparent on the face of the petition and established as a matter of law

Proving the Enforceability of the Provision at Trial

- **Must View Evidence as of the Time the Contract was Executed**
- *Presnal* (1990)

Liquidated or Actual Damages: You Can't Have Both

- Liquidated Damages Must Be “In Lieu” of Other Damages
- *Allpress* (1952)
- *Nexstar Broadcasting* (2008)

Risks: Undercompensation

- **Stipulating Dollar Amounts at the Outset Can Lead to Undercompensation**
- *Beard Family (2003)*

Risks: Overcompensation

- **Stipulating Dollar Amounts at the Outset Can Also Lead to Overcompensation**
- *Phillips (1991)*

Drafting Tips

- **Consider the 2-Part Test During Negotiations**
 - Think carefully about the difficulty of estimation and the reasonableness of the forecast during negotiations
- **If you advocate using a liquidated damages provision, be able to prove how it was derived.**