

DIMENSIONS

NO DAMAGE FOR DELAY AND LIQUIDATED DAMAGE CLAUSES IN PUBLIC CONSTRUCTION CONTRACTS

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A general contractor has entered into a construction contract with a public entity in New Jersey and the work commences. As always seems to be the case, there are delays on the project. Very often, the public entity seeks to collect damages from the general contractor for such delays while the contractor seeks extra time. Less often, as will be considered here, it is the general contractor who seeks damages as a result of delays and contends that those delays were caused by the public entity's actions or inactions.

A review of the contract reveals two key terms that address this issue. The first states that the contractor cannot recover for delay damages unless the actions of the governmental entity fall into certain limited circumstances ("no damage for delay" clause). The second relevant clause states that if the case falls into one of those limited circumstances, such delay damages are fixed at a per calendar or working day amount ("liquidated damage" clause). The question then becomes whether the contractor can recover any damages for delay and, if so, how much it can recover.

A "no damage for delay" clause, which provides that a party will not be entitled to any damages strictly as a result of the other parties' delay, can be considered an exculpatory clause. An exculpatory clause in a construction contract is valid and enforceable only if: (1) it does not adversely affect the public interest; (2) is not the result of the exercise of unequal bargaining power; and (3) is not otherwise unconscionable.

In the public contract area, New Jersey has two statutes which address the enforceability of a no damage for delay clause. N.J.S.A. 2A:58B-3 relates to contracts with the State of New

Jersey. More recently, in 2001, N.J.S.A. 40A:11-19 was enacted relating to Local Government contracts.

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N.J.S.A. 40A:11-19 invalidates and makes unenforceable a clause which limits "a contractor's remedy for the contracting unit's negligence, bad faith, active interference, tortious conduct, or other reasons unanticipated by the parties that delay the contractor's performance, to giving the contractor an extension of time for performance under the contract." In other words, the governmental contracting party cannot enforce a no damage for delay clause if its conduct falls into one of the categories stated. If the no damage for delay clause is unenforceable, then the issue becomes whether the fixed amount set in the contract for such delays is enforceable as a liquidated damage provision.

A valid liquidated damage provision is different than a "penalty", which is the sum a party agrees to pay in the event of a breach, but which is fixed, not as a pre-estimate of probable actual damages, but as a punishment, the threat of which is designed to prevent a breach. A contract that attempts to set a penalty for its breach is unlawful in New Jersey. A liquidated damages clause providing for an unrealistic sum, in a case where real damages are certain or readily reducible to certainty by proof, is deemed a penalty and is not enforceable. A liquidated damages provision is therefore enforceable only if: (1) the actual damages resulting from a breach are difficult or impossible to

ascertain; and (2) the damages agreed upon have a reasonable relationship to probable loss. Some New Jersey case law also states that a court may consider the reasonableness of the clause at the time of the breach, in addition to, or instead of, at the time of entering into the contract.

Typically, if the no damage for delay clause is unenforceable, the party who suffered from delays is seeking to recover the per day liquidated damage amount in the contract, rather than having to prove at trial the actual amount of damage it suffered as a result of the delays caused by the other party. An interesting issue arises where the liquidated damage provision is being enforced by the breaching party as a shield in the calculation of damages.

Thus, in a delay case, if the liquidated damage provision provides for fixed delay damages which turn out to be much less than the actual delay damages suffered, the non-breaching party may argue that such a "reverse" liquidated damage clause is actually a penalty to it, rather than to the breaching party and should therefore not be an enforceable liquidated damage provision. These issues must be carefully considered both at the time of contract negotiation and when considering options upon the occurrence of delays.

About the Author:

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