



Texas Supreme Court to Rule on Construction Contract No-Damages-For-Delay Clauses



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The Texas Supreme Court is poised to weigh in on recovery of delay damages in the face of no-damages-for-delay clauses and local governmental immunity.

The Texas Supreme Court granted petition for review and heard oral argument on November 6th on the appeal of *Port of Houston Authority of Harris County v. Zachry Construction Corporation*. At issue in the appeal is how no-damages-for-delay clauses—a common provision in construction contracts—are to be enforced in Texas against private owners and local governmental entities, as well as how lien releases should be interpreted. The Texas Supreme Court's decision could impact how both contractors and public entities allocate risk and assess project bids in Texas.

The underlying breach of contract dispute between Zachry and the Port Authority arose from delays in Zachry's construction of a wharf on Galveston Bay in which Zachry utilized a frozen wall to seal out water from the construction site. The original contract between Zachry and the Port Authority included a strict timeline and a no-damages-for-delay clause, a discussion of which may be found in the Winter 2013 *Capital Newsletter*: http://www.ccsb.com/pdf/Publications/RealEstate/Common_Law_%20Exceptions_May_Not_Apply.pdf.

The Port Authority decided to extend the wharf mid-construction in 2005, and Zachry's change order incorporated an additional frozen wall to accommodate the extension. The Port Authority's concerns over property damage from the additional frozen wall allegedly resulted in Zachry abandoning the concept altogether, which delayed Zachry's progress and increased costs. As a result of the delays, the Port Authority withheld \$2.36 million in liquidated damages.

Zachry sued the Port Authority in 2006 over the delays, increased costs, and withheld liquidated damages. The trial court awarded Zachry over \$23 million notwithstanding the no-damages-for-delay clause and lien releases issued by Zachry for the work encompassed by the withholding period.

The Fourteenth District Court of Appeals reversed Zachry's award and awarded \$10 million in attorney's fees to the Port Authority. The court ruled that the letter of the no-damages-for-delay clause reflected that the parties unambiguously considered any conduct by the Port Authority when they agreed that Zachry's only remedy for delay would be extension of time to complete the wharf. Therefore any common law exceptions to the clause, which formed the basis of the trial court's award, did not allow for delay damages.



Regarding the Port Authority's withholding of liquidated damages, the appellate court looked to the meaning of several Affidavit and Partial Release of Liens issued by Zachry for the period of the Port Authority's withholding, which provided as follows:

ZCC hereby acknowledges and certifies that Port of Houston Authority (PHA) has made partial payment to ZCC on all sums owing on Pay Estimate Number [] and that it has no further claims against PHA for the portion of the Work completed and listed on the Schedule of Costs in Payment Number [].

After examining the language of the releases and the circumstances surrounding their execution, the appellate court concluded that the only reasonable interpretation of the releases was that Zachry had no further claims for nonpayment of the covered portion of work. Thus even if the Port Authority was liable for withholding the liquidated damages, its withholding was excused by Zachry's releases.

The Port Authority claimed in addition that governmental immunity precluded the award of delay damages. Though the issue was not addressed by the appellate court, it was the focus of the Port Authority's oral argument before the Texas Supreme Court, and if ruled

upon could impact the structure of agreements with local governmental entities in Texas. The Texas Legislature waived local governmental immunity from suit for breach of contract, and provided in part in Section 271.153(a) of the Texas Local Government Code that the total amount of breach of contract damages would be limited to “the balance due and owed . . . under the contract . . . including any amount owed as compensation . . . as a direct result of owner-caused delays.”

The Port Authority argued that the no-damages-for-delay clause made explicitly clear that delay damages were not part of “the balance due and owed” under the Port Authority’s contract with Zachry, and that even without such a clause, delay damages are not recoverable against local governmental entities unless the contract expressly provides for them as part of the “balance due and owed.” Therefore, engrafting common law exceptions to allow for delay damages not provided for in a construction contract with a local governmental entity would be contrary to Texas public policy.

The Texas Supreme Court has not previously resolved whether or not common-law exceptions apply to no-damages-for-delay clauses, and its ruling on the issue would affect how contractors and project owners across Texas allocate risk. Should the appellate court’s decision be upheld, no-damages-for-delay clauses could encompass delays caused by the intentional as well as merely negligent conduct by project owners. Contract terms would more fully encompass the risks faced by delay, as no extra-contractual common-law exceptions would factor into risk allocation. At the same time, no-damages-for-delay clauses waiving delay damages for all conduct increase the risk born by contractors, which may upwardly impact the price of projects should owners prefer such contract provisions.

In addition, whether or not governmental immunity is waived for any common-law exceptions to no-damages-for-delay clauses would impact how contractors bid for local public projects. If common-law exceptions are found to apply to no-damages-for-delay clauses for private owners but not for local public owners, contractors would adjust bids for local public projects with comprehensive no-damages-for-delay clauses like in *Zachry* accordingly with the knowledge that they bear additional risk of delay.

The appellate court’s lien release ruling, whether or not ruled upon by the Texas Supreme Court, is instructive nonetheless in encouraging contractors to be mindful of the specific language used in their own releases. Zachry argued its releases only released liens and not its claims for the withheld amounts, which were in dispute at the time, but it was nonetheless bound by the releases’ language. The importance of the appellate court’s lien release holding has been attenuated by recent legislation adopting forms for lien releases in Section 53.284 of the Texas Property Code as of January 2012 and discussed in the Fall 2012 *Capital Newsletter*: (http://www.ccsb.com/pdf/Publications/RealEstate/Statutory_Form_Now_Required_for_Construction_Mechanics_Lien_Releases.pdf). The *Zachry* decision may prompt contractors to take a second look, however, at the language of lien releases executed before the legislature’s enactment.

The pending *Zachry Construction* decision merits the attention of contractors and project owners in the coming months, as it portends to shift risk allocation norms for construction delays across the State of Texas.