Michigan Court of Appeals Reinforces Limitations on "No Damages for Delay" and "Pay-If-Paid" Provisions

By Nicole S. Tersigni / May 14, 2015

It is well settled that both "No Damages for Delay" clauses and "Pay-if-Paid" clauses are generally enforceable in Michigan. However, the Michigan Court of Appeals, in an unpublished decision, recently tightened the reins on the enforcement of these provisions in certain contexts. In the April 2015 case of Macomb Mechanical, Inc. v LaSalle Group, Inc., -et al-, the Michigan Court of Appeals, ruling in favor of a subcontractor, held that:

A "No Damages for Delay" provision does not apply where the parties to the contract did not contemplate extensive delay at the time of contracting; and
A "Pay-if-Paid" provision in a subcontract may not apply to compensation for additional work where no change order was issued and the additional work never became part of the subcontract.

Prime Contractor LaSalle Group subcontracted certain plumbing and mechanical work to Macomb Mechanical, Inc. for the construction of a dining facility owned by the United States Army Corps of Engineers. Macomb asserted that at bid time, the job was scheduled to be completed in six months, but Macomb encountered unforeseen and different site conditions, ultimately extending Macomb’s work to 15 months. Macomb further asserted that the project scope changed after executing the subcontract, causing Macomb to incur additional costs. When LaSalle refused to execute change orders to secure payment, Macomb filed suit. Macomb sued LaSalle for breach of contract and LaSalle’s surety for payment under the surety bond. The lower court granted summary disposition against Macomb on both counts, on the basis that the subcontract contained (1) a broad “no damages for delay” clause, and (2) a pay-if-paid provision mandating that LaSalle receive payment from the owner before it was liable to Macomb. Accordingly, the lower court held that neither LaSalle, nor its surety, had any liability to Macomb.

On appeal, the Michigan Court of Appeals reversed, finding that a genuine issue of material fact existed whether (1) the parties contemplated such an extensive delay in the flow of work at the time of contracting; and (2) whether the additional compensation requested by Macomb, as well as any damages caused by delay or LaSalle’s actions of interference, fell outside the scope of the subcontract, rendering the pay-if-paid inapplicable.

As to the first issue, the Michigan Court of Appeals relied heavily on the fact that the owner issued a general stop-work order lasting three months, and LaSalle increased Macomb's costs during this delay by forcing Macomb to retain a presence on the site - requiring Macomb to wait to restart work, rather than pursue other opportunities to mitigate its damages. Macomb also presented evidence that LaSalle’s mismanagement of the project led to additional delay. The Court reasoned that Macomb presented a sufficient question of fact whether the parties contemplated this extensive delay, and whether Macomb could have contemplated that LaSalle would prevent it from mitigating damages during this delay. Thus, the Court questioned whether the No Damages for Delay clause could apply, given the unforeseen circumstances.

As to the second issue, the Court recognized the validity of the pay-if-paid clause with respect to monies owed under the subcontract. However, the Court distinguished monies owed for additional work, which Macomb claimed fell outside the scope of the original subcontract. Indeed, the Court accepted Macomb’s argument that, because LaSalle rejected Macomb’s change orders and never presented them for payment to the owner, a question of fact existed as to whether certain work was incorporated into the parties’ agreement, or remained “extracontractual” work. The Court concluded that if the work was outside the scope of the subcontract, it would not be subject to the pay-if-paid clause. Further, the Court attributed the same conclusion to delay damages, which, depending on resolution of the first issue, may also be outside the scope of the subcontract.

This Opinion recognizes the strict construction given to “no damages for delay” and “pay-if-paid” clauses, and provides a warning for subcontractors and general contractors alike. In light of this Opinion, general contractors must be aware that simply pasting these clauses into a subcontract may not completely defeat claims by the subcontractor for unreasonable delay or extracontractual work, and general contractors should never interfere with a subcontractor’s ability to mitigate its damages. Likewise, subcontractors should be careful to document work resulting from delay or change in project scope, even in the face of a subcontract appearing to limit such claims. As the Court of Appeals has demonstrated, certain actions (or inactions) by the general contractor may weaken the enforceability of these clauses. If you have any questions on the enforceability of such a clause, or its application to your project, consult your attorney or anyone in Clark Hill’s Construction Practice Group.