

Understanding the liquidated damages clause

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It is not uncommon for public works construction contracts to be finished after the original completion date that was established at contract award. Knowing this, owners often include "liquidated damages" clauses in their contracts to motivate contractors to complete on time, and to protect themselves from damages they could suffer if late completion does occur.

Liquidated damages are a fixed dollar amount, usually calculated on a cost per day basis, that an owner may charge a contractor for late completion that is the responsibility of the contractor. The intent of liquidated damages is to provide a reasonable estimate of damages the owner would suffer if the contractor fails to complete the project on time.

It is perfectly reasonable that owners be compensated for late completion when the late completion is the responsibility of the contractor. Unfortunately, in my consulting work, I encounter substantial abuse of liquidated damages, especially during final close-out of contracts.

I am currently involved with three contracts, in three different states, where liquidated damages are being misused by owners. In two of the cases, the owners are attempting to intimidate the contractors into accepting unfavorable settlements on various changes and impacts that occurred during performance of the contract. Threats of impending liquidated damages were made even before the issues of owner-caused delay, concurrent delay, and excusable delay, have been explored or agreed upon. In both projects, there are outstanding requests for equitable adjustment,

that include time extensions, which the owners have failed to respond to or acknowledge. The owners are attempting to substitute intimidation and threats for good contract management.

In the third case, the owner is attempting to assess liquidated damages for a period in which both the owner and the contractor were delaying the project.

Contractors who do a lot of public works contracting will probably encounter similar situations during the course of their professional lives. Those who have a basic understanding of liquidated damages will be able to effectively deal with these situations. Owners who share this understanding will know when liquidated damages are appropriate and when they are not. This will enable them to protect their contractual rights, and to avoid disputes that result from improper use of liquidated damages.

Some of the basic concepts regarding liquidated damages include:

● **Liquidated damages cannot be a penalty.** Liquidated damages cannot be enforced if they are a penalty. An example in which liquidated damages would be considered a penalty is where they were found to be an unreasonable forecast of the possible damages the owner would suffer in the event of late completion.

The Federal Acquisition Regulation (FAR) contains general policies that apply to federal construction projects concerning this principle at FAR 11.502. In part it says: "The rate of liquidated damages used must be reasonable and considered on a case-by-case basis since liquidated damages fixed without any reference to probable actual damages may be held to be a penalty, and therefore unenforceable. The

contract may also include an overall maximum dollar amount or period of time, or both, during which liquidated damages may be assessed, to ensure that the result is not an unreasonable assessment of liquidated damages."

● **Liquidated damages cannot be assessed for any period in which the contractor experienced an excusable delay.** This includes delay caused by the owner, and delay such as unusually adverse weather, or other "acts of God," such as a nation-wide transportation strike. All such issues that occur during the contract need to be quantified, agreed to, and incorporated into the contract with an appropriate time extension, before liquidated damages are considered.

When both the contractor and the owner are delaying substantial completion during the same period of time (concurrent delay), liquidated damages cannot be assessed. If the owner can establish, with methods such as critical path schedule analysis, that part of a delay was concurrent delay, and part of a delay was caused solely by the contractor, then it is appropriate for the owner to assess liquidated damages for the portion of the delay caused solely by the contractor.

What often happens at the jobsite is that both owners and contractors fail to deal with delay issues as they arise. In defense of owners, contractors are often remiss at submitting requests for time extension in a timely manner, and often do a poor job of justifying and documenting delay claims. This makes contractors susceptible to assessment of liquidated damages that may not be their responsibility.

In defense of contractors, owners sometimes fail to respond to time extension requests in a timely manner, or on the basis of the terms of the contract. As I have mentioned,

owners sometimes resort to threats and intimidation as a substitute for good contract management.

In my experience, owners and contractors who wait until the end of the project to address delay issues are inviting lawsuits.

● **Liquidated damages cannot be assessed after the date on which the contractor substantially completed the work.** Substantial completion is usually defined as the moment when the construction is capable of being used, or is available for its intended purpose.

There is no exact standard as to when substantial completion occurs, but the contractor must show that performance is near completion. In one case, the Armed Services Board of Contract Appeals ruled that government occupation of two buildings did not demonstrate substantial completion because work on the roofs of the buildings had yet to pass the contract testing requirements. All essential components of the project must function, and the project must be safe in order for the project to be substantially complete.

Also, the contractor must provide notice to the government that the work has been substantially completed and beneficial occupancy can take place in order for substantial completion to be established.

Owners and contractors who practice good contract management will not have to deal with liquidated damage issues very often. When the issue does arise, much confusion, and misuse of liquidated damages can be avoided by keeping these basic concepts in mind.

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