

Liquidated Damages For Delay—No Harm, No Foul

Liquidated damages (LDs) for delay can be an emotional topic for owners and contractors, as LDs come into play when a project is delayed and not progressing according to the parties' expectations. LDs may signal a troubled project, often leading to rising tensions that unfortunately divert attention and energy away from completing the project as expeditiously and economically as possible.

WHAT ARE LDs FOR DELAY?

LDs occur when a contractor agrees to pay an owner a fixed sum, either expressed as a percentage of the contract price or a fixed amount per day of delay in completing agreed-upon milestones or project completion dates. The term "liquidated" implies that the parties have expressly stipulated in the contract the damage amount to be recovered in the event of a contractor-caused delay, regardless of the actual damages incurred by the owner for the delay.

LDs are a benefit to the owner in that they provide a strong incentive for the contractor to complete its work in a timely manner. Some contractors view LDs as a means to control risk and avoid ambiguous or complex cost estimates.

The purpose of liquidating or stipulating the damages is to fix the amount to be paid in the event of delay, thereby avoiding the need for the owner and contractor to establish with certainty actual costs incurred due to delay. Most construction contracts indicate that the liquidated amount to be paid should not be construed as a penalty, but as a good-faith estimate of the actual damages that probably would ensue from the delay.

LDs typically are meant to cover the owner's costs for extended project management/oversight costs, the value of the loss of use of the facility, or the increased finance costs incurred by the owner as a result of the contractor-caused delay.

WHAT LDs ARE NOT

LDs are not intended to be a revenue stream to the owner for recovering project cost overruns and should not be intended to recover money from a contractor unless that contractor contributes to the project's delay by its actions or inactions. Additionally, LDs are not intended to be a penalty for the failure to complete on-time, but rather a reasonable approximation of the damages the owner estimates will incur due to contractor-caused delays.

THE LD DILEMMA

Larger and more complex construction projects often require the owner to place multiple prime contracts. Furthermore, multiple prime contracts often involve extensive interface and coordination issues among various contractors that the owner is typically required to manage. Multiple prime contracts can lead to an overall delay if the owner does not properly manage the project.

However, what happens when a contractor is late in completing a project, which ordinarily would result in paying LDs, but the owner has caused a concurrent delay elsewhere that delays it

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from obtaining beneficial use of the facility? Is the owner still entitled to collect LDs from the contractor if the owner could not have started the facility in any event, regardless of the contractor's delay?

A CASE STUDY OF LDs FOR DELAY

Assume the owner wishes to construct a natural gas-fired power plant and has decided to place two parallel prime contracts. The power plant contractor is responsible for building the combined cycle power plant, while the pipeline contractor is responsible for installing the natural gas pipeline that will supply gas to the

project. What happens if the pipeline contractor is nine months late in completing the natural gas pipeline, through no fault of the power plant contractor? At the same time, the power plant contractor was one month late in completing the power plant but the plant sat idle for eight months waiting for the pipeline contractor to complete the pipeline to supply the gas necessary to start up the power plant. Is the owner entitled to recover LDs from the power plant contractor for the one-month delay?

Many construction contracts would allow the owner to assess the power plant contractor with one month of LDs, as the power plant contractor was indeed late through no fault of the owner or the pipeline contractor. Does this seem fair considering that the owner could not have

started the power plant due to the pipeline contractor's delay? In other words, the owner would have incurred delay damages due to the pipeline contractor's delay, even if the power plant contractor had completed on-time.

**AN EQUITABLE ARGUMENT—
NO HARM, NO FOUL**

An equity argument can be made in this case study that the owner could not have started the plant even if the power plant contractor had completed on-time due to a lack of natural gas resulting from the pipeline contractor's delay. Therefore, the owner may not be entitled to recover damages from the power plant contractor because, through no fault of the power plant contractor, the owner would not have been able to start the facility and sell electricity. Using this argument, there is no reason to penalize the power plant

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contractor. The owner regardless would have suffered delay damages due to the pipeline contractor.

The parties to a contract should not disregard any contracts currently in force, but should consider a more equitable view of LDs for delay. A more equitable position could be for the parties to agree in the contract language that LDs for delay should be assessed only if the prime reason a project is delayed is due to the acts or omissions of the contractor. To this end, the parties may wish to include language in the contract similar to the following:

“Notwithstanding anything to the contrary elsewhere in the contract or in law, the owner and contractor agree

that no liquidated damages for delay shall become due and payable by contractor to owner unless the owner could have completed the facility and started receiving

beneficial use of said facility but for contractor's delay.”

This no-harm, no-foul philosophy is similar to the theory of concurrent delay, which is recognized by the courts. In concurrent delay, performance is delayed by causes attributed to both the contractor and the owner, thus neither party can recover compensation for the delay.

LDs for delay are an effective means to create a predictable method to calculate damages. However, when project conditions deteriorate and tensions rise, the parties are less likely to act in a fair and balanced manner when assessing delays and the resulting LDs. Agreeing upfront with the no-harm, no-foul concept allows contractors and owners to focus on completing a troubled project without the distracting debates over damages, yet still allows the owner to recover LDs for delay when justified.

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