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How to Avoid the Assessment When You Have Caused the Project Delay

Tom Olson

Anna Richie

By Tom Olson and Anna Richie

PROJECT DELAY IS AN UNWELCOME though regular visitor. If the delay were not caused by the contractor, then the contractor normally has a right to a time extension (if calendar-based) or non-charging of a working day.

Yet there are all too many occasions where the delay was caused by the contractor. When this occurs, the contractor normally has no right to additional time. The contractor is consequently exposed to paying liquidated damages.

The good news is that even if the contractor has no *factual* defense to the assessment of liquidated damages, the contractor may still have important *legal* defenses.

1. Amount of liquidated damages must be reasonable

Literally all public construction projects include a liquidated damages clause. As applied, the contractor is assessed a predetermined amount of liquidated damages for every day the contractor is late completing the work. But even if the contractor has no *factual* defense to the assessment (i.e., the contractor has caused the delay), the owner cannot assess liquidated damages *unless the amount of liquidated damages is reasonable.* In most states, this requires the owner to substantiate two things. Florida law provides a good view of what most states require.

First, the owner must normally demonstrate that the actual damages that may arise for late completion "are not readily ascertainable." *See, e.g., Lefemine v. Baron,* 573 So.2d 326, 328 (Fla. 1991). The classic example of such damages is "loss of use." In fact, I believe every DOT liquidated damages clause expressly states that the amount of liquidated damages is based on such "loss of use" or "inconvenience to the public." So if the project will cause "loss of use," then the owner may have a legal basis to satisfy this requirement. By contrast, if there will be no "loss of use" (e.g. the project is outside the limits of public travel), then the owner likely cannot satisfy this requirement. The owner may also not be able to satisfy the "readily ascertainable" requirement if the liquidated damages amount is based on "engineering costs." That is because such costs *can be readily ascertained:* preset hourly rates x hours of extra work.

Second, the daily liquidated damages amount "must not be so grossly disproportionate to any damages that might reasonably be expected to follow from a breach." *Goldblatt v. C.P. Motion, Inc.,* 77 So. 3d 798, 800 (Fla. 3d DCA 2011). If the owner cannot provide sufficient evidence of this and that the damages "are not readily ascertainable," then "the provision calls for an amount in damages that is excessive or unreasonable, and hence a penalty," in which case "the provision will not be enforced by the courts." *Secrist v. National Service Industries, Inc.,* 395 So.2d 1280 (Fla. Dist. Ct. App. 1981). As a potential example, DOT's typically establish the daily amount of liquidated damages according to the "Original Contract Amount." Yet the actual damages that may arise because of late completion could be *minimal* on a *large dollar rural project of limited public usage* while *huge* on a *small dollar city project located in the middle of downtown.* The point is determining the daily liquidated damages amount according to the *dollar value of the contract* is often arbitrary, and as a consequence, not a legally-justifiable determination.

Based on my experience of over 30 years in public construction, owners typically *have not satisfied the two legal requirements.* The reason that owners can and do assess liquidated damages notwithstanding this is because contractors are not familiar with these legal requirements and, as a consequence, owners need not justify their assessment of liquidated damages. Now that you know the law, contractors should request evidence for any proposed assessment on why the actual damages that may arise are "not readily ascertainable" and why the liquidated damages amount is a "reasonable" approximation of actual delay damages.

Contractors need to prepare for the typical owner response. Most liquidated damages clauses expressly provide that the liquidated damages are not a "penalty." But simply saying that does not mean it is true. Unless the owner can provide evidence as detailed above, the owner should not be legally entitled to assess liquidated damages. Contractors should recognize, however, that if the owner cannot assess liquidated damages, it likely can assess *extra engineering fees.* Given that the amount of extra engineering fees is typically far less than the proposed liquidated damages, the contractor should still save considerable money if it avoids the assessment of liquidated damages.

2. Liquidated damages should not be assessed after substantial completion

Along these same lines, it is well-settled *on a federal level* that liquidated damages cannot be assessed after a project is substantially complete. This axiom is based on the doctrine of "substantial completion," also commonly referred to as the doctrine of "substantial performance." One federal administrative agency appeal board explained the basis for this doctrine and its place in government construction contracts:

Faced with the reality that performance of a construction contract rarely results in total perfection, the courts and boards have developed the doctrine of "substantial completion." Under this doctrine, the harsh penalty of a default termination [or the assessment of liquidated damages] does not lie if the project as built has only minor deviations from the project as described in the specifications.

When assessment of liquidated damages is the issue, the test is an evaluation of the nature or work remaining to be done and the extent to which the project is capable of adequately serving the intended purpose.

Liquidated damages are intended to compensate for not having the use of a facility, a reasonable approximation of the expected cost to the owner from not having such use. Thus, when use of the facility commences, it is not reasonable to expect those costs to the owner will continue unabated.

Two State Constr. Co., DOT CAB Nos. 78-31, 1006, 1070, and 1081, 81-1 BCA ¶ 15149, at 89428 (1981) (citations omitted) (emphasis added).

This is not a recent development in construction contracts. Indeed, as far back as 1869, American courts have followed the doctrine of substantial performance. *See, e.g., Swain v. Seamens,* 76 U.S. 254 (1869) ("substantial performance . . . is all that is required to satisfy" a building contract). Since at least the early part of the twentieth century, courts have applied the doctrine of substantial performance to liquidated damages provisions in public construction contracts. For example, in *Peirce v. United States,* 50 Ct. Cl. 371 (1915), a contractor who built a dry dock for the United States Navy sought to recover the liquidated damages withheld on the basis that the dock was substantially complete a month before the Navy began assessing the liquidated damages. Citing *Swain,* and other federal and state cases recognizing the doctrine of substantial performance, the Court of Claims held: "According to these authorities, when the dock was reported as 'practically complete,' October 1, 1904, there was a substantial completion sufficient to satisfy all the requirements of the law. A claim for liquidated damages beginning November 1, 1904, is an absurdity." *Peirce,* 50 Ct.Cl. at 371.

Notably, the doctrine of substantial completion applies even though the underlying contract also specifies a "completion" date or required "final inspection" to establish that "all the work" is performed and accepted. In *Paul A. Teegarden,* IBCA 419-1-64, 65-2 BCA ¶ 5273 (1965), the government sought to enforce a liquidated damages provision past the substantial completion date based on "Contract Time" and "Final Inspection" clauses requiring completion of the all the work. *Teegarden* concerned the paving of a road for the National Park Service and the delayed completion of this work. *Id.* at 139457. Applying the "principle of substantial completion," the Department of Interior Board of Contract Appeals ("IBCA") held that the government could not assess liquidated damages after substantial completion. *Id.* The government moved for reconsideration arguing that the "Contract Time" and "Final Inspection" clauses established the completion date of the contract and also constituted exception to, or waiver of, the substantial completion doctrine. *Id.* The IBCA, however, affirmed its ruling that no liquidated damages could be assessed after substantial completion and noted that its decision rested on solid authority. *Id.* at 139457 and 139458.

Based on the above, as well as numerous other cases on this issue, there should be no dispute *under federal law* that liquidated damages cannot be assessed after a project is substantial complete. *See, e.g., Labco Constr. Co.,* AGBCA No. 90-115-1, 94-2 BCA ¶ 26,910, at 1443 (1994) (improper to assess liquidated damages because the project was substantially complete by the scheduled completion date); *J.W. Creech, Inc.,* ASBCA Nos. 45317 and 45454, 94-1 BCA ¶ 26,459, at 12080 (1994) (as a matter of law, liquidated damages may not be assessed under a construction contract where the project is substantially complete); *Gaffney Corp.,* ASBCA Nos. 37639 and 39740, 94-1 BCA ¶ 26,522, at 11957 (1993) (liquidated damages cannot be assessed for any period after substantial completion has occurred and only punch list items remain, even though the government did not take beneficial occupancy until sometime after substantial performance); *Seaboard Surety Co.,* ASBCA No. 43281, 93-1 BCA ¶ 25,510, at 14103 (1992) (liquidated damages may not be assessed under construction contracts after the date the work is substantially completed); *Matthew Andrew Kalosinakis,* ASBCA No. 41337, 91-2 BCA ¶ 23744, at 17664 (1991) (contractor entitled to remission of liquidated damages from date the facility was substantially complete); *Brooks Lumber Co.,* ASBCA No. 40743, 91-2 BCA ¶ 23984, at 17194 (1991) (contractor is not subject to liquidated damages for overruns beyond the substantial completion of the contract); *J.P., Inc.,* ASBCA No. 32327, 87-1 BCA 19453, at 27004 (1986) (whether liquidated damages were properly assessed depends on date when project was substantially complete); *Maysons Piping Contractors, Inc.,* ASBCA Nos. 28446 and 29036, 86-1 BCA ¶ 18626, at 29346 (1985) (the rule in construction cases is that liquidated damages are not assessed if the project is substantially complete). Commentators likewise acknowledge the general rule that liquidated damages cannot be assessed for any period subsequent to the date that the work is substantially completed. See *McBride & Wachtel,* Government Contracts § 34.130; Siegfried, Introduction to Construction Law § 8.03(d) (1987); and Bramble & Callhan, Construction Delay Claims § 2.40 (1992) (2d ed.).

While there is admittedly few of reported *state court decisions* on this issue, the same logic should apply equally on non-federal projects. In fact, I have successfully made this legal argument on many non-federal projects in which we *cooperatively resolved the issue outside of litigation.* Going a step further, I have successfully argued that no liquidated damages should be assessed if the project starts late, finishes late, but is completed *within the contract stipulated number of calendar or working days.*

In summary, while contractors should always seek to develop *factual defenses* to the assessment of liquidated damages (i.e. that the delay occurred *for reasons beyond the contractor's control*), contractors also should require owners to provide evidence on why the proposed assessment is *legal justified.* You will be surprised how effective this approach works to cooperatively resolve the proposed assessment of liquidated damages.

ABOUT THE AUTHORS

Thomas Olson is the founding partner of Olson Construction Law. Tom's commitment is to provide guidance on how to resolve issues on the jobsite, not in the courtroom. Tom has worked on highway heavy projects throughout much of the United States for more than thirty years. A prolific speaker and writer as well as attorney, his expertise is in concrete and asphalt paving, utility, earthwork and bridge construction, schedule analysis, material testing, and the technical and legal obligations of both engineers and contractors.

Anna Richie is a committed advocate who has exceptional attention to detail and a strong ability to understand relevant facts, contract rights, and law. Anna represents contractors, subcontractors, and suppliers in federal and state court, as well as mediation and arbitration. Anna is experienced in bond and mechanics' lien claims and has represented clients in disputes involving unmarked and mismarked utilities, design defects, differing site conditions, restricted site access, implied contractual duties, and other contract change issues.