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FIGHTING BACK AGAINST LIQUIDATED DAMAGES

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This time each year, as contractors hurry to complete school projects in time for fall classes, contractors and subcontractors are often working under the threat of liquidated damages. Owners and their consultants often keep the prospect of liquidated damages hanging over contractors' and subcontractors' heads to create incentives (or some would say, coercion) to finish the project on schedule. We are often asked to consult with our construction clients as to whether liquidated damages can be assessed against them. The enforceability of liquidated damages can be a complex issue. There are a few basic rules that all contractors and subcontractors should be aware of, as they may help to avoid being assessed liquidated damages which can make or break a project's profitability.



The first rule is that liquidated damages can only be assessed against a contractor if it caused "inexcusable delay." Inexcusable delays by a contractor are delays that are due to the fault or neglect of the contractor. In order to assess liquidated damages, the burden is on the owner to show that the delay to the completion date was due to the contractor's inexcusable delay. If the contractor has a legitimate excuse for the delay to the completion date, liquidated damages cannot be lawfully assessed. Common "excusable delays" are things like abnormally severe weather, additional work requested by the owner, change orders, errors and omissions in the design, force majeure events and delays caused by the owner's separate contractors. What constitutes inexcusable delay is often addressed between the parties in the contract, so it is critical to review the contract before making your argument about whether the delays were excusable or inexcusable.

The second rule is that, even where it can be shown that the contractor committed inexcusable delays, those delays must have been "critical delays" in order for liquidated damages to be assessed. That is, the inexcusable delays must have negatively impacted the project's critical path, which caused a late completion. Another important issue is whether the contractor's delay is concurrent with other delays that were caused by others. If the contractor's delay is critical and is concurrent with other delays, liquidated damages would not be permitted. For example, assume that a contractor fails to man a project for two weeks, but during that time period, the architect is working on a new design for an aspect of the project that the contractor is about to perform. In this scenario, owners often allege that the lack of manpower caused the delay. However, it is possible that the open design issue might still have caused critical delay even if the contractor had a full crew at the site for the entire two weeks. If so, the delays may be considered to be *concurrent* and it would be improper to assess liquidated damages against the contractor. Thus, if the customer accuses you of delay citing inadequate manpower or other issues, it is important to carefully examine the entire project and its critical path to determine which issues actually caused critical delay and to determine whether other delays were concurrent with the contractor's delay. It is not unusual for delays to be the product of multiple participants and events. An owner has the duty to apportion critical delays if there is more than one cause.

Assuming that the contractor is responsible for delays due to its own fault or neglect (inexcusable delays), the liquidated damages contract provision might still be unenforceable. Liquidated damage clauses will only be enforced where certain elements have been met. First, the liquidated damages must be a *reasonable estimate of the actual damages* that the owner expects to incur if the project is completed late. This estimate must be prepared before the contract is signed. The owner must have made a good faith

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effort to determine what its actual damages would be if the project was delayed, and the liquidated damages amount must reflect that amount. Often, this pre-contract assessment is not made at all and the owner (or its consultant) simply plugs in a daily figure for liquidated damages into the contract. The figure is sometimes an amount that the owner or its consultants have used on prior projects. Or, it may simply be an arbitrary amount that the owner or its consultants believe is sufficient to scare the contractor into finishing on time. If you can show that the liquidated damages were not the product of a good faith pre-contract estimate and are just intended to force an on-time completion, the liquidated damages clause might not be enforced. It will be considered a penalty, rather than a legitimate attempt to establish damages. Some owners make the mistake of actually referring to the liquidated damages cause as a penalty clause in the contract or using words to that effect when discussing liquidated damages in emails and letters. If this has occurred, it will be difficult for the owner to assess liquidated damages because a court is likely to strike it down as an unenforceable penalty.

In summary, liquidated damages are complex, and there are numerous arguments contractors can make to defend against and, in some cases, defeat them. As with many issues in construction, good record-keeping and documentation are important. If you are being delayed, make a record of it, notify your customer and request additional time. Even if the owner refuses to acknowledge the delays and refuses to grant additional time, these records will be very valuable in defeating liquidated damages assessments.



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