

## Liquidated Damages - Unintended Consequences and an Alternate Solution

Most building Owners need to occupy their finished facility by a date certain, so they often put a clause in the construction contract stipulating that penalties or liquidated damages, **LDs**, are to be paid by the Contractor to compensate for Owners' losses if the agreed upon completion date is not met. LDs give an Owner comfort—in theory. **In actual practice, however, LDs are virtually never paid by a General Contractor, and in fact, more often than not they cause unintended losses for the Owner.**

### Here's why:

- To the maximum extent possible, all General Contractors delegate liability and risk, including LD exposure, down into subcontracts with trade contractors and suppliers who are less financially able to sustain costs imposed by LDs. Those subs seldom have any control over the whole project, but they are motivated by fear of devastating losses if any LD delay is blamed on them. Therefore, they tend to increase their initial bids to offset the added risk of LDs, which become an invisible and non-refundable additional cost to the Owner.
- Construction has become ever more complex and dependent on a high degree of coordination and teamwork if quality work is to move quickly toward completion. However, teamwork and efficiency evaporate under the constant threat of LD penalties. Subcontractors seek self-protection from risk of LDs which, ironically, adds to the likelihood that the project will go slower and miss the completion date—adding even more risk of harm to the Owner.
- Any General Contractor or Construction Manager who encourages the Owner to include LDs for the GC to use as a way to force their subcontractors into schedule compliance is just paying lip-service to the 'partnering' concept and portraying the Owner, not the GC, as the subs' opponent. Project -management-by-threat-of-LDs undermines teamwork and obstructs any sense of loyalty to the Owner. It is also a red flag warning of potential conflicts to come.
- Subs can only control their own actions, so under time pressure of LDs, they naturally try to rush their work even more than would be the case just to maintain schedule. If another trade is not "out of the way" fast enough, the precedent work is rushed and/or covered over in greater haste to avoid LD charges—fear usually trumps concern for workmanship. Loss of quality and impacted building performance is yet another hidden, but very real, cost of LDs to the Owner.
- In the end, though, if/when the stipulated Completion Date is missed, most Contractors immediately counter by redefining "completion", counter-claiming due to "extenuating circumstances", and/or blaming the designer and the Owner or all the above. Expensive, protracted litigation over those related issues can exceed the dollar amount of LDs as well as cause other problems, so the wasted energy of conflict is usually better and more productively applied to a belated effort to get the Owner into operation ASAP. The damage is done. But even in the absence of a pre-agreed amount for Liquidated Damages, the Owner still may have recourse via breach-of-contract litigation for *actual* Consequential Damages if all else fails.

**For all these reasons, Liquidated Damages simply don't work.** It is never a 'surprise' when a project ends up behind schedule—a lack of scheduled progress should have been obvious to *everyone* long before Completion Day. Who was monitoring the project for the Owner, and if schedule was so important, who was certifying monthly payment applications as being in compliance with the contracted schedule? And if progress was behind schedule due to unforeseen conditions, was there no Contingency fund to deal with that? Or, if delay was due to circumstances under Contractor control, did the specifications not contain provisions that compel the Contractor to accelerate promptly to get back

on schedule? Having to impose LDs at the end is actually an admission that everyone involved waited too long to even acknowledge the problem earlier and did not respond cooperatively when delays began—at the point where necessary corrective actions were still possible and still reasonably economical to implement.

**But there are two alternatives, and they almost always do work:**

1. In specification Section 007300 GENERAL AND SUPPLEMENTARY CONDITIONS, modify the AIA A201 General Conditions **§3.10.1 CONTRACTOR'S CONSTRUCTION AND SUBMITTAL SCHEDULES** as follows: require the Contractor to submit at the start of construction a cost-loaded Critical Path Method (CPM) schedule along with a detailed Construction Progress chart showing costs and estimated progress for the various components of the Work. The chart should present a composite curve showing estimated cost progress for the project. Then, insert in **§3.10.1: "If actual progress of the Work falls behind the estimated progress as indicated by the charts, the Contractor must, at no additional cost to the Owner, accelerate the Work back into compliance with the approved CPM Schedule in a time period and manner satisfactory to Owner and Architect."**
2. And/or specify a bonus as incentive for achieving an exceptional completion objective or another project-specific benefit for the Owner. **Note:** careful consideration is necessary, however, in order to keep an incentive for speedy completion from undercutting quality of the work in a rush. In reality, LDs do not motivate a General Contractor with fear because any losses will fall on the backs of subcontractors. But a bonus—it doesn't have to be very large—does motivate the GC because they get to keep that extra profit for themselves. Consequently, a Contractor virtually never fails to achieve the incentive bonus attached to targeted completion or extraordinary performance.

For all these reasons, Owners should carefully consider the cost/benefit risks of LDs. The far better alternative is to require that the Contractor use cost-loaded Critical Path Method scheduling (including a tight acceleration clause in the specifications) followed by all parties closely monitoring progress during construction. An incentive bonus can also be negotiated to achieve a specific objective. A quality project delivered on budget and on time—without the negative impacts of Liquidated Damages—is to the benefit of both Owner and Contractor.

### **About the Author**

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