

# Time Is Money

## *Contractual Treatments of Delay Damages*

BY KENNETH M. BLOCK

One of the more contentious issues in construction contract negotiations between owners and contractors involves the availability of liquidated or consequential damages to the owner in the event of the contractor's delayed performance. In this article, we will explore the principles of owner damages in general and discuss alternative contractual treatments of delay damages. We will also report the results of an informal survey we conducted among construction lawyers (hereinafter, "the survey participants") relating to the issue of contractual delay damages.<sup>1</sup>

### General Principles

#### A. Actual Damages

We begin with the fundamental principle which underlies much of the jurisprudence dealing with the measure of damages for defects or omissions in the performance of a construction contract—namely, that an owner is entitled to receive what it bargained for and should therefore be restored to the position in which it would have been had the contractor complied with the terms of the contract.

Perhaps the most obvious remedy available to an owner to redress such a situation is a suit to recover its "actual" or "direct" damages. These damages have been characterized as those which naturally arise from the breach and can reasonably be said to have been foreseen or contemplated at the time the contract was made. New York, like many other jurisdictions, provides two alternative measures of direct damages. The first,

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known as the "cost rule," measures damages by determining the cost of completing or repairing the incomplete or defective work in accordance with the original specifications.<sup>2</sup> The lesser-used "value rule" is employed where the correction of certain defects would cause unreasonable destruction of otherwise usable property, or where it would involve unreasonable expense and require the undoing of a substantial portion of the work that has already been completed. Damages pursuant to the "value rule" are calculated by taking the difference between the fair market value of the project if it had been built according to specifications and the value of the project as it was actually built.

#### B. Consequential Damages

In addition to direct damages, owners may recover consequential damages from a contractor that breaches its contract or performs defective work. Consequential damages differ from direct damages in that consequential damages

may not, necessarily, flow naturally from the breach, although they were reasonably within the contemplation of the parties when they entered into the contract. In order for an owner successfully to recover consequential damages in its suit against a contractor, the owner must establish that: (1) such damages were caused by the breach; (2) the damages sustained were within the parties' contemplation when the contract was entered into; and (3) the amount of damages are measurable with reasonable certainty. More often than not, consequential damages in the construction context result from delays in construction and can include, among other things, storage costs, material escalation, additional or increased interest costs, consultant expenses and lost profits.

In the private construction context, additional or increased interest costs are a very real concern. Most private owners finance their projects through relatively high interest rate construction loans, and intend to convert those loans to lower-rate permanent loans once construction is complete. Obviously, if there is a delay in construction, the owner is forced to suffer through the higher interest rates of the construction loan for longer than originally anticipated and, perhaps, budgeted. In addition, these very same construction delays may force the owner to accept an interest rate on its permanent financing that is substantially higher than it would have been able to negotiate had no delay occurred. These additional expenses caused by the construction or design professional are recoverable under New York law as consequential damages.<sup>3</sup>

#### C. Liquidated Damages

An alternative to the actual or consequential damage remedy for delay are liquidated damages clauses that assesses a predetermined dollar amount against the breaching party in lieu of actual or consequential damages. These clauses

are especially helpful when there has been a loss due to a delay in construction; the owner does not then have to undergo the difficult task of proving the damages attributable thereto. Typically, these clauses specify a daily sum that the contractor will be charged for each day the project is delayed past the contract completion date. While some liquidated damages clauses not only contain provisions which penalize the contractor for delay, but also reward it for early completion, such reciprocity is not required in order for the liquidated damages provision to be considered valid and binding under New York law.

A liquidated damages clause is enforceable under New York law so long as it does not attempt to penalize a party. As explained by the New York Court of Appeals, a liquidated damages clause will be upheld if the "damage presumed to result from nonperformance of a contract is uncertain and incapable of exact ascertainment" and provided the sum stipulated to be paid by the defaulting party is not, "when interpreted as of the date of the agreement, grossly disproportionate to the presumable or probable damage, or to the readily ascertainable loss."<sup>4</sup> If the stipulated sum is "grossly disproportionate" to the presumed damages, it will be treated as a penalty and likely deemed unenforceable. Similarly, if the liquidated damages clause goes beyond merely compensating the aggrieved party for its loss, but rather serves to coerce a party's performance, it will likewise be labeled a penalty.<sup>5</sup>

Finally, all delay damages clauses should provide that when the owner or third party or event (i.e., force majeure) is responsible for some of the delay that has occurred during construction, the contract period may be extended for causes beyond the contractor's control.

### Contractual Treatment

Agreements between owners and contractors can provide a variety of treatments for an owner's delay damages. (Notably, however, it should be noted that the commonly used AIA forms of agreements do not expressly provide for liquidated damages, but do provide for a waiver of consequential damages.)

Before requesting the inclusion of liquidated damages (or "LDs") in the contract, the effect of LDs on the ongoing relationship between the owner and contractor should be considered. It is generally believed that the presence of LDs creates an adversarial relationship between the parties at the outset and has a chilling effect on the "team approach" to construction contracting.

Notwithstanding this negative effect on the parties, the survey participants, on average, report that close to one-half of all contracts in which they have been involved call for liquidated damages. However, where LDs are included, the survey

participants report that their contracts include provisions limiting the contractor's total liability for LDs, generally ranging from 50 percent of the contractor's fee to twice the contractor's fee.

The first exercise in a contract negotiation of LDs is the determination of a per diem rate that fairly reflects the owner's damages for delay, and a commonly used measure is the owner's extended cost of construction financing. Often, a grace period is provided (say, 30 days) before LDs are assessed; however, in the event substantial completion of the project is not achieved by the end of the grace period, LDs are assessed from the first day of delay. Additionally, where a contractor accepts LDs it is not uncommon for the contractor to insist upon a bonus for early completion.

Where LDs are not provided in the contract, a contractor is fully exposed to all delay damages incurred by an owner unless there is a waiver of consequential damages. In view of this, even

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where there is no blanket waiver of consequential damages, those damages may be limited to specific types of damages, such as increased financing costs or lost rent. The survey participants report that the majority of their contracts include some form of a waiver of consequential damages and that a significant number of their contracts have partial waivers limiting the contractor's exposure to only specific types of consequential damages. As with liquidated damages, the survey participants report that where consequential damages have not been partially or fully waived, they are limited in the same manner as liquidated damages; that is, from 50 percent of the contractor's fee to a multiple of the fee.

### Project Scheduling

Because the mere mention of liquidated or consequential damages creates contractual acrimony, the issue of the imposition of such damages may best be avoided by careful project scheduling, utilizing anything from traditional bar charts or graphs to complex critical path method ("CPM") programming. In this way, delays in the

progress of construction can be identified early in the process and mitigation measures can be implemented immediately.

A concomitant to careful CPM scheduling is the inclusion of an acceleration clause in the construction contract. Under such a clause, where a delay is identified as being the responsibility of the contractor (i.e., not an owner or force majeure delay), the contractor is responsible to provide additional manpower to make up the delay at its sole cost and expense. In this manner, while the contractor (or, more accurately, its subcontractors) may incur additional costs, those costs will be far less than the damages the owner (and the contractor) would suffer if the project is not completed in a timely fashion.

### Conclusion

Now more than ever, the mantra of "time is money" dominates the construction industry, and the damages the owner and contractor can suffer from delayed completion can be catastrophic. However, while contractual provisions can be created to penalize or reward a contractor for delayed or early completion, the best course to ensure the timely completion of the project is through a team approach using careful project scheduling. Timely completion results in the ultimate win-win situation for both the owner and contractor.



1. Earlier this summer we conducted an informal e-mail survey of several New York construction lawyers. These lawyers represent both owners and contractors and, while there was a broad range of responses to our various inquiries relating to the contractual treatment of liquidated damages and consequential damages, we were able to discern certain trends which are reported in this article.

2. See *Bellizzi v. Huntley Estates, Inc.*, 3 N.Y.2d 112 (1957); *Kaiser v. Fishman*, 187 A.D.2d 623 (2d Dep't 1992).

3. *Cooperstein v. Patrician Estates*, 117 A.D.2d 774 (2d Dep't 1986).

4. *Associated General Contractors, New York State Chapter, Inc. v. Savin Bros.*, 45 A.D.2d 136, 139 (1975).

5. *City of Rye v. Public Service Mut. Ins. Co.*, 34 N.Y.2d 470 (1974).