ENFORCEMENT OF LIQUIDATED DAMAGES PROVISIONS IN CONSTRUCTION CONTRACTS IN CASES OF MUTUAL DELAY BY OWNERS AND CONTRACTORS IN THE CONSTRUCTION INDUSTRY

Gyms, Inc., a hypothetical Virginia construction company, contracts with a local government to build a public gymnasium. Pursuant to the contract, Gyms is to construct the facility and to install all wall mats, basketball hoops, gym bars, game clocks and other necessary equipment. Gyms also assumes responsibility for landscaping of the facility, paving of an auxiliary parking lot, and other jobs related to construction of the facility, but which are not absolutely necessary for its opening. The parties execute a 150-page contract which, along with its other provisions, states that time is of the essence and provides for liquidated damages to be assessed for each day completion is delayed beyond a specified date. Work is commenced by Gyms upon receipt of an order to proceed, and four months later, on the specified completion date, the finished facility is turned over to the government owner. A typical situation? Not at all.

Even a hypothetical owner and contractor are likely to be subjected to delays caused by inclement weather, unavailability of supplies, scheduling difficulties, and a number of other potential complications. When the owner is solely responsible for the delay, the contractor will usually seek an extension for completion. It may also recover financial losses resulting from any unreasonable delay on the part of the owner in court.[1] If the delay is instead caused by the contractor or its agents, the government will assess liquidated damages for each day's delay.

Yet in this hypothetical, as is often the case in reality, both parties have contributed to the delay in completion. The government's delay is in providing the game clocks, which can be installed in one day but must be in place for the facility to host basketball games. Gyms, while waiting for the clocks, proceeds with the paving and landscaping for 60 days past the completion date, at which time the clocks arrive and are installed.

Should the government be allowed to enforce its contractual remedy for damages due to the delay in completion of landscaping and paving, or should the time provision of the contract be nullified? If the time provision of the contract is negated, should Gyms be allowed a reasonable amount of time to complete its work on the clocks following the government's delay, leaving the government to prove actual damages for any recovery it seeks? More specifically, this article will discuss whether the local government can recover anything when both parties are at fault and when the delay of a contractor such as Gyms, though sizeable

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[1]. Atlantic Coast Line R. v. A. M. Walkup Co., Inc., 132 Va. 386, 390, 112 S.E. 663, 664 (1922).

when compared with the government's, did not prevent the facility from opening and thus caused no actual damages.

CONSTRUCTION CONTRACTS AND LIQUIDATED DAMAGES

In construction contracts, a provision granting liquidated damages for each day's delay is an appropriate means of inducing performance or of providing compensation when either party fails to perform.[2] Parties may properly contract for such a provision when actual damages at the time of the agreement are uncertain and difficult to measure. The courts will enforce the provision unless damages at the time of breach are susceptible of definite measurement (as in breach of an agreement to pay money) or when the stipulated amount would be grossly in excess of actual damages. As in any type of contract, the focus is on the intent of the parties as evidenced by the entire contract, and by the circumstances under which the contract was made.[3] As long as the amount designated as liquidated damages is a reasonable expression of the parties' intent at the time of the contract, the fact that no actual damages are ultimately suffered by the contractee is irrelevant.[4]

Construction contracts such as that between the hypothetical parties above are precisely the types of contracts where liquidated damages provisions are best used. Given the number and variety of duties assigned to the contractor, potential actual damages are incapable of being precisely ascertained at the time the contract is made. The liquidated damages provision, by setting a fixed rate of compensation, serves as an estimate of damages which would be sustained by the owner regardless of the nature of a delay, rather than as a means of compensating for the breach of a particular component of the contract.

Viewed in this light, a provision allowing the withholding of an amount which is not disproportionate to the probable (rather than actual) loss due to a contractor's delay will not be construed as an invalid penalty and is enforceable as liquidated damages.[5] Where, however, the contractor's delay is not the sole delay, an amount that would ordinarily be considered an appropriate measure of damages may be deemed unacceptable.

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[2]. Robinson v. United States, 261 U.S. 486, 488 (1923).

[3]. Taylor v. Sanders, 233 Va. 73, 75, 353 S.E.2d 745, 746-47 (1987). Although this is a real estate case, the real estate and construction industries are similar in this respect.

[4]. *See* Robinson v. United States, 261 U.S. at 488.

[5]. Taylor v. Sanders, 233 Va. at 76, 353 S.E.2d at 747.

MAJORITY VIEW: THE ROLE OF NONAPPORTIONMENT

There are two lines of opinion on the issue of whether a liquidated damages provision may be enforced when both the owner and the contractor contribute to a delay in construction. Under the majority view, an owner who has caused a substantial delay in the beginning or progress of work without agreeing to an extension is prohibited from claiming liquidated damages, even if the contractor is also responsible for the delay.[6]

In *United States v. United Engineering & Contracting Co.*[7], a contractor who had accepted a reduced payment under protest was able to recover liquidated damages withheld by the government after showing that much of the delay in its construction of a building had been caused by delays in the completion of surrounding buildings by other contractors hired by the government. The court refused to apportion the owner's and contractor's delay and held that since the government had prevented performance of the contract within the stipulated time, even though the work was also delayed through the fault of the contractor, liquidated damages were waived, and the government could recover only proven actual damages.[8]

The following language of the court's opinion states the oft-quoted "rule of nonapportionment" now applied by many states and lower federal courts:

> We think the better rule is that when the contractor has agreed to do a piece of work within a given time and the parties have stipulated a fixed sum as liquidated damages not wholly disproportionate to the loss for each day's delay, in order to enforce such payment the other party must not prevent the performance of the contract within the stipulated time, and that where such is the case, and thereafter the work is completed though delayed by the fault of the contractor, the rule of the original contract cannot be insisted upon, and liquidated damages measured thereby are waived.[9]

In adopting this rule, the court was influenced by the fact that supplemental agreements between the government and United Engineering during the course of construction made no reference to liquidated damages.[10] Some lower courts have interpreted the rule more broadly on the theory that the parties' mutual delays place the date of completion beyond the term of the contract. Because courts must be able to fix the day from which a liquidated damages clause is to apply, it

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6. Annotation, *Liability of Building or Construction Contractor for Liquidated Damages for Breach of Time Limit Where Work is Delayed by Contractee or Third Person*, 152 A.L.R. 1349, 1359-60 (1944).

7. 234 U.S. 236 (1914).

8. *Id.* at 242.

9. *Id.*

10. *Id.*

is claimed, apportionment cannot be made where no definite date for completion remains.[11] In any event, the owner is again relegated to proving actual damages.

THE MINORITY VIEW: APPORTIONMENT ALLOWED

Where a contract contains an explicit time extension provision, most courts will assume that the parties intended an apportionment of responsibility for delay to be made, and will allow the owner to recover a liquidated sum for the period of delay attributable to the contractor.[12] Under the minority view, apportionment is permitted even where no contractual provision for time extensions has been made. A delay caused by the owner does not necessarily discharge the forfeiture clause but only entitles the contractor to a credit against his period of default (in a sense, an automatic extension).[13]

The primary authority for the rule permitting apportionment is *Robinson v. United States.*[14] In *Robinson*, the contractor, relying on *United Engineering*, argued that because the government had caused some of the delay in construction, the liquidated damages provision was unenforceable. The court, however, distinguished *United Engineering*, in stating that, but for the government's action in that case, the contractor's work would have been completed within the contract period.[15] Because the contractor in *Robinson* had agreed to pay at a specified rate for each day's delay not caused by the government, the court found that a clear intent was shown for the contractor to pay for some days' delay, even if relieved from paying for other delays because of the government's action. As a result, the government did recover liquidated damages for the days of delay attributable to the contractor.[16]

APPORTIONMENT/NONAPPORTIONMENT IN THE FOURTH CIRCUIT

In the Fourth Circuit, case law both supports and limits the rule of nonapportionment. Because the circuit's mutual delay decisions were all made prior to *United Engineering* and *Robinson*, it is unclear how these later cases may have affected the state of the law in Virginia. In *Jefferson Hotel Co. v.*

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[11]. *Annotation, supra* note 6, at 1364-65.

[12]. Cushman, Ficken & Sneed, *Delays and Disruptions*, in CONSTRUCTION LITIGATION 123 (R. Cushman ed. 1981).

[13]. Annotation, *supra* note 6, at 1369.

[14]. 261 U.S. 486 (1923).

[15]. *Id.* at 489.

[16]. *Id.* at 488.

Brumbaugh,[17] the court did not require a general contractor to pay a contract penalty of $150 per day of delay because independent contractors hired by the owner had contributed to the delay. Though the hotel company urged that its contractors had only been responsible for a few days' delay, the court refused to apportion their delay with that of the general contractor. The court held that the general contractor, as a builder, was entitled to work in an undisturbed, systematic manner and that the court could not know, months later, what conditions had contributed to the overall delay, so it would not attempt to apportion the delay.[18]

In *Caldwell & Drake v. Schmulbach*,[19] a case decided shortly after *Jefferson Hotel*, the court, relying on that decision, refused to apportion the delay between an owner and contractor, even though the parties' contract expressly provided for apportionment. The causes of delay in construction of a building included difficulty of access to the construction site, which was hemmed in by surrounding buildings, necessity of protecting the buildings adjoining the site, and most notably, a set of architectural plans which provided for a building larger than the lot on which it was to be constructed. According to the court, these circumstances demonstrated clearly the impossibility of a court's attempting to determine and apportion the cause of delay between an owner and contractor when both were in default. Consequently, no private contract by its terms could change the law prohibiting apportionment or could compel a court to do so.[20]

Jefferson Hotel and *Caldwell & Drake* appear to indicate a general adherence to the rule of nonapportionment in the fourth circuit. Indeed, both cases are currently referenced as authority supporting that rule.[21] The decision in *Caldwell & Drake*, however, was modified on appeal in *Schmulbach v. Caldwell*,[22] where, rather than focusing on the difficulties a court might have in apportioning mutual delay, the court emphasized the parties' agreement that the contractor would pay $50 per day in liquidated damages for delays not caused by inclement weather or the owner. The court distinguished *Jefferson Hotel*, where the payment for each day's delay was designated in the contract as a penalty, stating that, where parties had provided for a stipulated sum as liquidated damages, courts should

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17. 168 F. 867 (4th Cir. 1909).

18. *Id.* at 874-75.

19. 175 F. 429 (C.C.N.D. W.Va. 1909).

20. *Id.* at 434.

21. *See* 17A C.J.S. *Contracts* Sec. 502(4)(a) (1963).

22. 196 F. 16, 28 (4th Cir. 1912).

give effect to their intent by not holding the amount to be a penalty or refusing to enforce the contract provision.[23]

In further attempting to distinguish *Jefferson Hotel*, the court pointed out that whereas the court in *Jefferson Hotel* had found it impossible to separate mutual delays, here the parties had provided for a means of apportionment in the contract. Regarding this issue, the court said:

> [W]e are not aware of any principle of law, which prevents or relieves the court from apportioning the delays when, **either by competent and satisfactory evidence, or by a contractual standard fixed by the parties**, they can do so with reasonable certainty.[24] (emphasis added).

Because the owner could show the number of days for which he was entitled to liquidated damages and could point to a contract requiring the defaulting party to share the number of days for which he was entitled to be credited, nonapportionment was inapplicable.[25]

The contractual language in *Schmulbach* (providing the contractor with a credit for days "when the weather forbids work" and "for each and every day he is delayed by the owner")[26] makes that agreement closely analogous to contracts explicitly providing for time extensions, which do not come under the rule of nonapportionment. However, based on the court's reference to consideration of *evidence* establishing responsibility for delay (as opposed to the parties' contractual standard), it would seem that whenever the impossibility of apportioning delay is not at issue (either because the parties have provided a means of apportionment, as in *Schmulbach*, or because the delays attributable to each party are easily separated, as in the Gyms hypothetical), it would not be inherently unfair for a court to apply a forfeiture clause, stipulated in advance by the parties, to the contractor's portion of the delay.[27]

Coal & Iron Ry. v. Reherd[28] indicates still another circumstance under which a Fourth Circuit court may be willing to allow apportionment. In *Reherd*, though the parties' contract did not expressly provide for a time extension where the owner's actions interfered with timely completion, the court found that because the contract conferred on the owner the authority to require additional work by

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[23]. *Id.* at 25-26.

[24]. *Id.* at 27.

[25]. *Id.*

[26]. *Id.* at 18.

[27]. *Id.* at 27.

[28]. 204 F. 859 (4th Cir. 1913).

the contractor, the parties' consent to a reasonable extension of time for completing the extra work could be implied.[29]

Under the implied extension rationale, fault for any delay beyond the reasonable period necessary to complete the extra work was attributed to the contractor. The court held that though the owner had increased the work, which would necessarily require more time, when a reasonable time had elapsed for the contractor to complete the increased work, it would be liable in liquidated damages for delays beyond that reasonable limit of time.[30] Thus, relying on its interpretation of the parties' agreement and intent, the court allowed enforcement of the forfeiture clause, even though specific provision for time extensions had not been made and the owner's actions had contributed to the delay.

COMPETING POLICIES

Though the more recent decision of *Robinson v. United States* can be read as limiting the instances in which a court refuses to apportion damages to situations such as that in *United States v. United Engineering & Contracting Co.* (where the contractor would have completed construction as scheduled had the owner's agents not caused an intervening delay), many courts continue to adhere to a general rule of nonapportionment. The policies that support the rule involved arise from unique aspects of the construction industry. Delay in one part of construction usually disturbs the whole, the length of an interruption does not necessarily correspond to the resulting delay, and complicated evidence makes it difficult to separate the delays attributable to each party.[31] The certainty, apparent evenhanded treatment of owner and contractor, and ease of application of the nonapportionment rule make it attractive from an administrative point of view.[32]

Nevertheless, the practical effect of a refusal to apportion delay, granting the contractor an extension of time for completion but denying him any monetary recovery for the delay, while at the same time precluding the owner from collecting liquidated damages for late completion, may result in injustice to both parties.[33] If the government in the Gyms hypothetical had failed to inspect the building for two months, which in turn prevented the contractor from proceeding with additional phases in the construction process, Gyms, though perhaps grateful for an exemption from paying liquidated damages for any delay on its part, might

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[29]. *Id.* at 880.

[30]. *Id.* at 881.

[31]. Annotation, *supra* note 6, at 1376-77.

[32]. Phillips, Stetson, Bramble, *Construction Disputes and Time*, in ISSUES IN CONSTRUCTION LAW 49, 65 (1988).

[33]. *Id.*

find that exemption wholly disproportionate to its losses over the two-month waiting period.

A better solution would be to grant Gyms an implied extension and to allow it to present a claim for "extra work" as in *Coal & Iron Ry. v. Reherd.* On the other hand, if, as in the original hypothetical, Gyms were responsible for two months' delay in performing one part of the contract (the landscaping and paving), while the government defaulted with respect to a part of the contract which in no way affected Gyms' ability to landscape and pave, which required only one half day's work, and which, had Gyms not also been in default, would probably have been excused altogether,[34] it would be unfair to allow Gyms to capitalize on the government's inability to obtain clocks by refusing to uphold the forfeiture clause.

In addition to the equitable considerations supporting apportionment, there are practical reasons for allowing the parties' contractual provisions for damages to stand. First, improvements in methods of scheduling analysis and the detail of critical path management have made allocation of responsibility for delay less difficult than it may have been when the rule against apport
ionment was being developed.[35] An increased faith in the ability of triers of fact to sort out complicated evidence also weighs in favor of allocation.

Finally, there is the liquidated damages provision itself. In the Gyms hypothetical, the parties, at the time the contract was made, agreed to a liquidated sum as a measure of potential actual damages which could not otherwise be ascertained. Though the rationale behind the refusal of many courts to enforce liquidated damages provisions in cases of mutual delay may be that such provisions act as a penalty,[36] the fact remains that if a claim is for measured or liquidated damages expressly agreed upon by the parties to be compensation for potential actual damages, the principles involved regarding the enforcement of penalties do not apply.[37]

It would be inconsistent for a court to rule that an owner who has contributed to construction delay is allowed to recover actual damages, only to ignore the owner's (and contractor's) provision for those damages. Today, when construction contracts cover hundreds of facets of a given project, are thoroughly negotiated by both sides, and are deliberately designed to protect both owner and

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[34]. Reid v. Field, 83 Va. 26, 1 S.E. 395 (1887). A contractee is entitled to accept less than full performance, and the government would have done so in the interests of avoiding unnecessary expense.

[35]. Phillips, Stetson, Bramble, *supra* note 32, at 66.

[36]. Annotation, *supra* note 6, at 1378.

[37]. Schmulbach v. Caldwell, 196 F. 16, 25-26 (4th Cir. 1912).

contractor from unpredictable events, there is no reason to sacrifice the parties' freedom to address problems of mutual delay in the interests of judicial economy and adherence to an archaic rule of law.