

or as contractually delineated liquidated damages. The contract may also provide that the owner may terminate the contractor for failure to complete the project in a timely manner.

Similarly, delays caused by the owner are excusable to the contractor and compensable to the contractor. An owner may cause delays by providing defective plans and specifications to the contractor, not allowing the contractor access to the site at the agreed-upon time, failing to coordinate the activities of multiple contractors, and failing to approve shop drawings in a timely manner.

The contractor generally must give written notice of an excusable delay to an owner when it is requesting a time extension or other relief. Written notice may not always be required, however, if the delay was caused by the owner or if the owner had actual notice of the delay and was not prejudiced by the failure to receive notice of the delay.

*Acceleration* involves a speeding up of the work process. When a project is accelerated, the work must be accomplished in less time than was originally anticipated and/or budgeted. The contractor typically must increase the number of work hours over a given period of time, either by working overtime, hiring additional manpower, or both. Equipment and supervision costs also necessarily increase when a project is accelerated.

There are two types of acceleration: directed acceleration and constructive acceleration. *Directed acceleration* occurs when the owner orders the contractor to speed up the pace of the work. Whenever an owner directly accelerates a contractor, the owner is liable to the contractor for its acceleration costs.<sup>13</sup> Many construction contracts contain provisions that explicitly allow the owner to order the contractor to accelerate its work.

*Constructive acceleration* occurs when a contractor is forced to increase the pace of work to meet a project schedule that has not been extended even with the presence of excusable delays. Although the owner does not directly order the contractor to accelerate the work, the owner requires the contractor to complete the project under the original timetable that, because of the excusable delays, results in the work being accomplished in less than the originally budgeted time. Courts have held that a contractor must prove five elements in order to recover under a theory of constructive acceleration:

1. An excusable delay;
2. Notice to the owner of the excusable delay and a request for a time extension;
3. Refusal by the owner to grant the extension within a reasonable time;
4. An order, either express or implied, to accelerate; and

<sup>13</sup> *Norair Eng'g Corp. v. United States*, 666 F.2d 546 (Ct. Cl. 1981); *See also Mobile Chem. Co. v. Blount Bros. Corp.*, 809 F.2d 1175 (5th Cir. 1987).

#### 5. Actual acceleration by the contractor.<sup>14</sup>

The definition of what constitutes an excusable delay is often found in the contract. In general, excusable delay is a delay beyond the control of, and not caused by the fault or negligence of, the contractor. Defective plans and specifications, owner-ordered changes in the work, and the failure of the owner to make timely deliveries of materials are examples of occurrences that may lead to excusable delays. Without proof of an excusable delay, a contractor may not recover under a theory of constructive acceleration.

Once an excusable delay has been encountered, the contractor must give notice of the delay to the owner and request a time extension. Although some courts have allowed recovery without notice to the owner when the owner's conduct showed that it was aware of the delay and was allowing the acceleration, actual notice and request is always the more prudent course.

The third element needed to establish constructive acceleration is the owner's refusal to grant the time extension. If the requested time extension is granted, no acceleration will be necessary because the work can proceed at the expected pace and finish on a later date. However, if the owner still insists on the original completion date, or a date that, though extended, does not account for all excusable delays, the contractor will still need to accelerate to complete the job on time.

After failing or refusing to grant a time extension, the owner must then either expressly or implicitly order the contractor to accelerate. An express order to accelerate always fulfills this element of proof, but implied orders to accelerate may also be enough to prove the contractor's claim. Although the mere failure of the owner to act on a request to accelerate, or expressions of concern about the progress of the work, have been held not to be implied orders to accelerate, an owner's refusal to grant a reasonable time extension combined with a demand to complete the work in the original time frame does satisfy this requirement.<sup>15</sup>

Finally, the contractor must show that it actually accelerated its performance. The contractor may produce pay records showing overtime worked or additional manpower used above that which was budgeted in the original bid to meet this burden of proof.

*Disruption* claims are based on events that preclude the contractor from completing the work in the manner in which the work was bid. Owner-caused disruptions can be the result of incomplete or incorrect contract drawings, changes in the work, failure to respond to questions in a timely manner, or failure to approve shop drawings in a timely manner. Other disruption claims may be based on weather,

<sup>14</sup> *Nat Harrison Assocs. v. Gulf States Utils. Co.*, 491 F.2d 578 (5th Cir.), *reh'g denied*, 493 F.2d 1405 (1974); *Norair Eng'g Corp. v. United States*, 666 F.2d 546 (Ct. Cl. 1981); *Envirotech Corp. v. Tennessee Valley Auth.*, 715 F. Supp. 190 (W.D. Ky. 1988).

<sup>15</sup> *Norair Eng'g Corp. v. United States*, 666 F.2d 546 (Ct. Cl. 1981); *Nello L. Teer Co. v. Washington Metro. Area Transit Auth.*, 695 F. Supp. 583 (D.D.C. 1988).



labor problems, and the like. As with delay claims, not all disruption claims are compensable.

The significant difference between delay and disruption claims lies in the types of damages the claimant seeks to recover. Claims for delay necessarily extend the time for project completion and result in damages for extended home and field office overhead, equipment rental, and financing. Claims for disruption, however, may not extend the completion date but may be based on additional labor and labor inefficiency due to the effects of overtime, the stacking of trades, having to do the work out of sequence, and field installation of material that should have been completed offsite. Thus, although both delay and disruption claims may be based on owner interference with the work, the damages suffered by the contractor are quite different. Additionally, although many contracts contain a "no damages for delay" clause, few preclude damages for owner-caused disruptions. Therefore, a contractor who would be unable to recover for a delay claim might be able to recover for a disruption claim.

Contractual limitations on delay or disruption claims must be analyzed very carefully. Differences do exist between provisions that insulate a party from liability and provisions that merely place a limit on liability.<sup>16</sup> Exculpatory clauses are disfavored and generally unenforceable. Limitation of liability clauses are generally enforceable as long as they are reasonable and are not so drastic as to remove the incentive to perform with due care. However, they also are generally not enforceable with respect to precluding actions resulting from intentionally tortious conduct.<sup>17</sup> When a party does not exercise due care in performing its required duties under a contract, the inevitable result is a finding that the non-performing party was the first to breach the contract.<sup>18</sup>

### [C] Payment Claims

Critical to every contractor is the expected cash flow under the payment terms of the contract. When payment is not made or is made in an untimely fashion, not only are bottom-line profits affected, but the contractor's capital, financing, ability to perform other projects, bonding capacity, and obligations to employees, subcontractors, and material suppliers are all negatively impacted. Failure to make prompt payment can be a death knell for many contractors.

<sup>16</sup> Posttape Assocs. v. Eastman Kodak Co., 537 F.2d 751 (3d Cir. 1976); DiFrancesco v. Western Pa. Water Co., 478 A.2d 1295 (Pa. Super. Ct. 1984).

<sup>17</sup> Valhal Corp. v. Sullivan Assoc., 44 F.3d 195 (3d Cir. 1995), *reh'ng denied*, 48 F.3d 760 (3d Cir. 1995); Valley Forge Convention & Visitors Bureau v. Visitor's Service, Inc., 28 F. Supp. 2d 947, 950 (E.D. Pa. 1998).

<sup>18</sup> See, e.g., Allied Fire & Safety Equip. Co. v. Dick Enters., 972 F. Supp. 922, 933 (E.D. Pa. 1997); Grimme Combustion v. Mergentime Corp., 595 A.2d 77 (Pa. Super. Ct. 1991), *appeal denied*, 607 A.2d 254 (Pa. 1992); Coatesville Contractors & Eng'rs. v. Borough of Ridley Park, 506 A.2d 862 (Pa. 1986); Gasparini Excavating Co., v. Pennsylvania Turnpike Comm'n, 187 A.2d 157 (Pa. 1963).

Contractors traditionally have had little leverage in dealing with this type of claim outside the normal claim process. Now, however, prompt payment acts<sup>19</sup> may add stiff penalties for failure to make timely payments or for wrongfully withholding payments. Significant interest and penalties maybe awarded on balances due, and attorneys' fees are recoverable by "substantially" prevailing parties. Prompt payment claims should be considered by every contractor in addition to the elements of cost recognized and discussed in Chapter 13.

### [D] Termination Claims

Contractors often find themselves threatened with termination for allegedly improper performance or failure to comply with certain contractual provisions. A party may terminate a contract but only if the breach is material and occurs prior to substantial completion. A minor or partial breach ordinarily does not relieve a party of its duty to perform under the contract.<sup>20</sup>

To determine whether a breach is material, the following factors are considered:

1. The extent to which the injured party will be deprived of the benefit it reasonably expected;
2. The extent to which the injured party can be adequately compensated;
3. The extent to which the party failing to perform will suffer because of the forfeiture;
4. The likelihood that the party failing to perform will cure the alleged failure;
5. The extent to which the behavior of the party failing to perform comports with the standard of good faith and fair dealing;
6. The extent to which the contract has been performed at the time of the alleged breach;
7. Whether the breach was willful or caused by negligence or extraneous circumstances; and
8. The seriousness of the breach from the standpoint of what was bargained for. A minor breach may allow the aggrieved party to recover damages or a set-off against the breaching party, but does not excuse the aggrieved party from performing; a material breach entirely discharges on aggrieved party's obligation to continue performance.<sup>21</sup>

<sup>19</sup> See, e.g., Contractor and Subcontractor Payment Act, 73 Pa. Cons. Stat. Ann. §§ 501-516 (1994).

<sup>20</sup> Tyro Indus. v. Trevoise Constr. Co., 737 F. Supp. 856 (E.D. Pa. 1990).

<sup>21</sup> Restatement (Second) of Contracts § 241 (1981); United States v. SAMCO Constr. Co., 39 F. Supp. 2d 661, 670 (E.D. Va. 1999); United States v. Morano Constr. Corp., 724 F. Supp. 88 (S.D.N.Y. 1989); Greyhound Lines v. Bender, 595 F. Supp. 1209 (D.D.C. 1984).



If an owner terminates a contractor absent a material breach's occurring, then the contractor may cease work and sue the owner for breach of contract.<sup>22</sup>

Similarly, even if omissions exist, an owner may be liable for wrongfully terminating after a contractor has substantially completed contract performance.<sup>23</sup> Substantial completion may be determined by considering the cost to complete the project in relation to the overall contract price.<sup>24</sup> Such liability can be particularly appropriate given the owner's implied duty not to interfere with or hinder the contractor's progress.<sup>25</sup>

### § 1.03 OWNER CLAIMS

The owner has rights to enforce contract provisions against noncomplying contractors. In today's economic climate, no owner is in a position to fund the faults of the contractor. The owner certainly is entitled to timely and professional performance from its contractor. Avenues for recovery are available and may be pursued when defects and delays become apparent during construction.

#### [A] Delay Claims

Time is critical in almost every construction project. No benefit accrues to the owner until construction is complete. Until then, the owner is on the paying end of the equation. If a project is not completed on time, the owner may face the risk of a market collapse, the loss of use of the project, financing penalties, and many other losses that are not subject to easy calculation or determination.

For these reasons, many contracts include provisions for liquidated damages designed to reasonably approximate the losses that an owner may suffer. As long as the liquidated damage sum is reasonable in relation to the anticipated losses and the owner has not contributed to the delay in completion, these clauses are generally enforceable against the contractor.<sup>26</sup>

When a contract does not include a liquidated damage clause, the owner may recover the actual damages suffered as a result of the delay. *Actual damages* include both direct and consequential damages.

<sup>22</sup> A-1 Gen. Contracting Inc. v. River Mkt. Commodities Inc., 622 N.Y.S.2d 378 (App. Div. 1995); Statler Mfg. v. Brown, 691 S.W.2d 445 (Mo. Ct. App. 1985).

<sup>23</sup> West Dev. Group v. Horizon Financial, F.A., 592 A.2d 721 (Pa. Super. Ct. 1991); Delta Constr. v. Dressler, 381 N.E.2d 1023 (Ill. App. Ct. 1978).

<sup>24</sup> Prudential Ins. Co. v. Stratton, 685 S.W.2d 818 (Ark. Ct. App.), *rev. denied*, 692 S.W.2d 230 (Ark. 1985); Orgeron v. Dobkowski, 476 So. 2d 458 (La. Ct. App. 1985); Fluidair Prods. v. Robeline-Marthaville Water Sys., 465 So. 2d 969 (La. Ct. App. 1985).

<sup>25</sup> S. Leo Harmonay, Inc. v. Binks Mfg. Co., 597 F. Supp. 1014 (S.D.N.Y. 1984), *aff'd*, 762 F.2d 990 (2d Cir. 1985); Vermont Marble Co. v. Baltimore Contractors, 520 F. Supp. 922 (D.D.C. 1981); Winn-Senter Constr. Co. v. Katie Franks, Inc., 816 S.W.2d 943 (Mo. Ct. App. 1991); Craig Coal Mining Co. v. Romani, 513 A.2d 437 (Pa. Super. Ct. 1986), *alloc. granted*, 522 A.2d 50 (Pa. 1987).

<sup>26</sup> A.O.D. Constr. Co. v. Town of Plymouth, 1995 WL 357347 (Conn. Super. Ct. June 5, 1995).

*Direct damages* are those damages that naturally flow from the delay, such as lost rental value, interest rate difference between construction loan and permanent loan financing, construction management fees and overhead, storage and cost of materials, and potential claims from other contractors. *Consequential damages*, on the other hand, are losses that arise from special circumstances but were within the contemplation of the parties at the time they executed the contract. These may include lost profits on sales, an increase in production costs during the period of delay, or penalties from financing commitments. Of course, adequate records are key to establishing either direct or consequential damages. **Chapter 12** provides a detailed analysis of these damages.

#### [B] Cost of Corrective Work

Owners find themselves at times in the position of having to correct a contractor's defective work. This may occur after the contractor has left the project or during construction, when the contractor for financial or other reasons is incapable of performing the corrective work. Many contracts include exclusive remedies to cap a contractor's liability or limit the owner to a specified remedy, such as repair and replacement.

Such exclusive remedy provisions are generally held to be valid and fully enforceable, however careful consideration must be given to whether the provisions attempt to limit remedies based in tort or contract.<sup>27</sup> However, when a contractor makes repeated, unsuccessful attempts to cure defective work, exclusive remedy provisions will not be enforced, and the owner will be entitled to recover an amount approximating the owner's loss of the benefit of its bargain.<sup>28</sup>

This result fully comports with the remedies available to the owner who, without such a contract provision, is entitled to recover either the repair or replacement value of the work<sup>29</sup> or the diminished value of the project.<sup>30</sup> The *diminished value theory* is normally applied when the cost of correcting the defective work would result in economic waste.<sup>31</sup>

<sup>27</sup> Valhal Corp. v. Sullivan Assocs., 44 F.3d 195, *reh'g denied*, 48 F.3d 760 (3d Cir. 1995); New York State Elec. & Gas Corp. v. Westinghouse Elec. Corp., 564 A.2d 919 (Pa. Super. Ct. 1989).

<sup>28</sup> Barrick v. Kolea, 651 A.2d 149 (Pa. Super. Ct. 1994).

<sup>29</sup> Clayton Ctr. Assocs. v. Schindler Haughton Elevator Corp., 731 F.2d 536 (8th Cir. 1984); Armstrong Transfer & Storage Co. v. Mann Constr., 458 S.E.2d 481 (Ga. Ct. App. 1995); Bloomsburg Mills v. Sordoni Constr. Co., 164 A.2d 201 (Pa. 1960).

<sup>30</sup> Clayton Ctr. Assocs. v. Schindler Haughton Elevator Corp., 731 F.2d 536 (8th Cir. 1984); Mort Wallin, Inc. v. Commercial Cabinet Co., 784 P.2d 954 (Nev. 1989); George A. Shegdan, Inc. v. Standard Merchandising Co., 332 A.2d 498 (Pa. Super. Ct. 1974).

<sup>31</sup> Camino Real Mobile Home Park Partnership v. Wolfe, 891 P.2d 1190 (N.M. 1995); Business Men's Assurance Co. v. Graham, 891 S.W.2d 438 (Mo. Ct. App. 1994); Groves v. John Wunder Co., 286 N.W. 235 (Minn. 1939).



## [C] Termination Claims

Termination is the most draconian remedy available to an owner. For that reason, the owner must carefully comply with every contractual provision and take all reasonable steps before exercising it.<sup>32</sup>

An owner may be deemed to have waived the right to terminate the agreement if the owner allows the contractor to continue performance after the material breach.<sup>33</sup> It is imperative that the owner give notice to the contractor, providing reasonable time for proper performance, before exercising the right to terminate.<sup>34</sup> Moreover, the owner cannot take advantage of any obstacle the owner has placed in the contractor's path as a reason to terminate the agreement. In other words, where the owner claims that a condition has not been satisfied, but where that same owner is the cause of the condition not being satisfied, that same owner cannot claim non-occurrence to its advantage.<sup>35</sup> In essence, the owner must be innocent of any wrongdoing and must follow the very letter of all applicable contract provisions before exercising this right, or the owner would be subject to a wrongful termination claim.

## [D] Tort Claims

When the contractual relationship totally collapses, the parties are likely to raise tort claims as well as contract claims. Typical tort claims include tortious interference with contractual or other advantageous relations, fraud, misrepresentation, and negligence. The number of possible tort claims is limited only by the imagination of the legal professionals involved.

Because the relationship between the contractor and owner is fundamentally based on contract, often the parties include provisions barring the assertions of tort claims between them.<sup>36</sup> However, such provisions do not preclude claims by or against parties not privy to the contractual relationship, including claims by the contractor against design professionals.

Typical litigation scenarios see contractors suing design professionals for negligent misrepresentation or alleging that they are third-party beneficiaries of the owner-design professional contract. These theories draw a fine line between tort and contract, between the nature of the duties owed and the kind of injury that is compensable, and courts are split over which ones to recognize. Thus, the *Restate-*

<sup>32</sup> Gunter Hotel v. Buck, 775 S.W.2d 689 (Tex. Ct. App. 1989).

<sup>33</sup> Dicon, Inc. v. Marben Corp., 618 F.2d 40 (8th Cir. 1980); Warner Co. v. MacMullin, 112 A.2d 74 (Pa. 1955).

<sup>34</sup> Dallas-Fort Worth Regional Airport Bd. v. Combustion Equip. Assocs., 623 F.2d 1032 (5th Cir. 1980); Devito v. United States, 413 F.2d 1147 (Ct. Cl. 1969).

<sup>35</sup> McDermott v. Party City Corp., 11 F. Supp. 2d 612, 621 (E.D. Pa. 1998); A-1 Gen. Contracting v. River Mkt. Commodities, 622 N.Y.S.2d 378 (App. Div. 1995); Craig Coal Mining Co. v. Romani, 513 A.2d 437 (Pa. Super. Ct. 1986), *alloc. granted*, 522 A.2d 50 (Pa. 1987).

<sup>36</sup> Otis Elevator Co. v. Don Stodola's Well Drilling Co., 372 N.W.2d 77 (Minn. Ct. App. 1985).

*ment (Second) of Torts* recognizes a cause of action for negligent misrepresentation in the context of design professional responsibility for faulty or inadequate construction documents,<sup>37</sup> but does not recognize the nearly identical notion of negligent interference with contract.

Many courts have addressed this tension by adopting what is commonly referred to as the *economic loss doctrine*.<sup>38</sup> Simply put, the economic loss doctrine holds that design professionals are not liable for any alleged negligence that results in purely economic damages to a contractor with whom they share no contractual relationship. The contractor must instead pursue the owner on a contract claim. The economic loss doctrine has been interpreted to prevent recovery of economic damages for negligent misrepresentation when the claimant's resulting losses arise from a prior contract arrangement.<sup>39</sup> The economic loss doctrine, by definition, does not preclude personal injury or property damage claims.

Other courts, of course, have adopted the *Restatement* approach by expressly allowing a contractor to pursue tort-based claims against design professionals regardless of the nature of the damages claimed. The line is constantly changing, and courts have reversed positions once thought to be solidly held.<sup>40</sup>

Before pursuing any tort claims, however, consideration must be given to the nature of the damages claimed, whether those damages are recoverable in contract, and the added cost of pursuing a tort theory of recovery that will be hotly contested by the opposing party.

In *MacGlashing v. Dunlop Equipment Co.*,<sup>41</sup> Charles MacGlashing was injured when an elevated work platform collapsed while he was using it. The platform was leased by defendant/appellee Dunlop Equipment (Dunlop) to MacGlashing's employer, third-party defendant/appellant Restoration Preservation Masonry, Inc. (RPM). MacGlashing and his wife sued Dunlop and Dunlop sued RPM, invoking the lease indemnification clause. The MacGlashings settled with Dunlop prior to trial. The issue on appeal was whether the MacGlashings, standing in the shoes of Dunlop, could collect the settlement amount from RPM under the indemnification clause of the lease between RPM and Dunlop.

Summary judgment was granted in favor of the MacGlashings and Dunlop. RPM argued on appeal that it had no obligation under the lease agreement to indemnify Dunlop for damages flowing from MacGlashing's accident because Dunlop had materially breached the agreement. Alternatively, RPM also challenged

<sup>37</sup> Restatement (Second) of Torts § 281 (1965); *Chrischilles v. Griswold*, 150 N.W.2d 94 (Iowa 1967).

<sup>38</sup> *Linde Enters., Inc. v. Hazelton City Auth.*, 602 A.2d (Pa. Super. Ct.), *alloc. denied*, 617 A.2d 1275 (Pa. 1992).

<sup>39</sup> *Palco Linings v. Pavex, Inc.*, 755 F. Supp. 1269 (M.D. Pa. 1990).

<sup>40</sup> See, e.g., *Casa Clara Condominium Ass'n, v. Charley Toppino & Sons*, 620 So. 2d 1244 (Fla. 1993) (specifically limiting prior case law and instead holding economic loss theory available to prevent recovery by homeowners against suppliers of concrete absent proof of physical harm to persons or property).

<sup>41</sup> 89 F.3d 932 (1st Cir. 1996).



the contractor to accelerate its work. For example, an owner's threat to terminate the contract for default if the contractor does not finish the project on time, despite excusable delays, is generally sufficient to qualify as an acceleration order.<sup>88</sup> Similarly, an owner's intention to assess liquidated damages for late completion may constitute an order to accelerate.<sup>89</sup> In one case, the owner's introduction of interim milestone dates that were not part of the contract qualified as a directive to accelerate the project, entitling the contractor to acceleration costs.<sup>90</sup>

However, some actions may be insufficient to constitute an order to accelerate. An owner's mere expression of concern regarding the timeliness of performance has been held not to be an acceleration order.<sup>91</sup> So long as the owner takes reasonable and justifiable actions to ensure that the project is timely completed, such actions generally will not be construed as a directive to accelerate.<sup>92</sup>

#### [4] Owner's Refusal to Grant Time Extension

In a constructive acceleration case, a contractor must also prove that the owner failed to grant the contractor a proper time extension. A failure to meet this element will result in the denial of a constructive acceleration claim.<sup>93</sup> In these cases, the primary issue is whether a time extension should have been granted. If the court finds that a time extension should have been granted, then it holds that the contractor was constructively accelerated.<sup>94</sup> If the court finds that the time extension was properly denied because the delay was nonexcusable or that the contractor failed to submit proper documentation to support the time extension, then the owner will generally prevail.<sup>95</sup>

A contractor's burden of showing that the owner refused to grant a time extension is clearly satisfied when the owner expressly denies the contractor's time extension request.<sup>96</sup> However, an owner's inaction may also amount to a denial if

<sup>88</sup> See, e.g., *Intersea Research Corp.*, IBCA No. 1675, 85-2 B.C.A. (CCH) ¶ 12,058 (1985); *Lewis Constr. Co.*, ASBCA No. 5509, 60-2 B.C.A. (CCH) ¶ 2,732 (1960).

<sup>89</sup> See *Procon Corp. v. Utah Dep't of Transp.*, 876 P.2d 890 (Utah Ct. App. 1994); *Azure v. United States*, 129 F.3d 136 (Fed. Cir. 1997).

<sup>90</sup> *Hurst Excavating, Inc.*, ASBCA No. 37351, 93-1 B.C.A. (CCH) ¶ 25,893 (1993).

<sup>91</sup> See, e.g., *Allen Bender, Inc.*, 91-2 B.C.A. (CCH) ¶ 23, 828 (1991).

<sup>92</sup> See, e.g., *Iverson Constr. Co.*, 76-1 B.C.A. (CCH) ¶ 11,844 (1976); *Fermont Div., Dynamics Corp. of Am.*, ASBCA No. 15806, 75-1 B.C.A. ¶ 11,139 (1975).

<sup>93</sup> See, e.g., *Iconco*, 224 Ct. Cl. 692, 27 Cont. Cas. Fed. (CCH) ¶ 80,392 (1980) (contractor failed to show that its request for a time extension had been denied or that owner's failure to act was equivalent to denial for purposes of constructive acceleration).

<sup>94</sup> See, e.g., *Contracting & Material Co. v. City of Chicago*, 20 Ill. App. 3d 684, 314 N.E.2d 598 (1974) (owner's refusal to grant justified time extensions resulted in constructive acceleration), *rev'd on other grounds*, 64 Ill. 2d 21, 349 N.E.2d 389 (1976).

<sup>95</sup> See, e.g., *Tri-Cor, Inc. v. United States*, 458 F.2d 112 (Ct. Cl. 1972); *McDevitt & St. Co. v. Marriott Corp.*, 713 F. Supp. 906 (E.D. Va. 1989); *Feuerland-Werkstätten GmbH*, ASBCA No. 32,970, 87-3 B.C.A. (CCH) ¶ 20,012 (1987); *Intermax, Ltd.*, ASBCA No. 41828, 93-2 B.C.A. (CCH) ¶ 41,828 (1993).

<sup>96</sup> See *Western Contracting Corp.*, ENGBCA No. 3855, 82-1 B.C.A. (CCH) ¶ 15,486 (1982)

the owner fails to timely review and take action on a contractor's request. Not only must an owner grant a justifiable time extension, an owner also has an affirmative duty to review a time extension request and to act within a reasonable time on that request.<sup>97</sup> Therefore, an owner's delay in considering a contractor's request for additional time may be deemed as a refusal to grant a time extension, even though the owner ultimately extends the contractor's time for performance.<sup>98</sup>

Obviously, the timeliness of an owner's actions will be examined on a case-by-case basis, and will depend on a variety of factors, such as the procedures used in reviewing a contractor's time extensions, whether the time extension request was properly submitted, and when such extensions should have been granted under the circumstances.<sup>99</sup>

The more difficult case to resolve is when the owner grants a time extension to the contractor, but the contractor claims that the time extension was insufficient to cover the excusable delay. Under this scenario, the contractor must provide two levels of proof. First, the contractor must prove that it was entitled to a time extension. Second, the contractor must demonstrate that the extension granted by the owner was less than the extension to which it was entitled. For example, if a contractor is granted a 100-day extension by the owner, and the contractor completes the project within that 100-day extension but feels that it was justifiably entitled to a 150-day extension, then the contractor would claim that it was constructively accelerated by 50 days. Whether the contractor will be able to prove its acceleration claim depends on whether it can prove not only that it was entitled to the 100-day extension that it received, but also that it was entitled to the additional 50-day beyond the 100-day extension.<sup>100</sup>

The contractor, however, may find that it waived its claim to the additional 50-day extension if it accepted the 100-day extension without taking exception. A contractor who accelerates its performance without giving the owner notice of all its claimed time extensions may be deemed a volunteer. Thus, a contractor who accepts a 100-day extension and completes performance within that 100 days, but never gives the owner notice that it is entitled to an additional 50-day extension may be found to have voluntarily accelerated itself for that 50-day period.<sup>101</sup>

(default termination held improper because contracting officer failed to grant time extensions for delays resulting from weather, strikes, flooding, etc.); *Hewitt Contracting Co.*, ENGBCA No. 3790, 79-2 B.C.A. (CCH) ¶ 14,016 (1979) (default termination held improper because contracting officer failed to account for excusable causes of delays).

<sup>97</sup> See, e.g., *Contintental Heller Corp.*, GSBCA No. 6812, 84-2 B.C.A. (CCH) ¶ 17,275 (1984); *Tyee Constr. Co.*, IBCA No. 692-1-68, 69-1 B.C.A. (CCH) ¶ 7,748 (1969); *Algernon Blair, Inc.*, ASBCA No. 45369, 94-2 B.C.A. (CCH) ¶ 26, 638 (1994).

<sup>98</sup> *Atlantic Dry Dock Corp.*, ASBCA No. 42609, 98-2 B.C.A. (CCH) ¶ 30,025 (1998).

<sup>99</sup> See, e.g., *Nello L. Teer Co. v. Washington Metro. Area Trans. Auth.*, 695 F. Supp. 583 (D.D.C. 1988); *Algernon Blair, Inc.*, ASBCA No. 45369, 94-2 B.C.A. (CCH) ¶ 26,638 (1994).

<sup>100</sup> See, e.g., *Freeman Elec. Constr. Co. v. United States*, 618 F.2d 124 (Ct. Cl. 1979), *cert. denied*, 449 U.S. 825 (1980).

<sup>101</sup> See *Bart Assocs., Inc.*, EBCA No. C-9406176, 97-2 B.C.A. (CCH) ¶ 29,206 (1997).



Similarly, a contractor's acceleration claim will be barred if the contractor executes or accepts a change order for the accelerated work. Because a change order is simply a contract modification, a contractor who accepts or executes a change order may be found to have assented to being accelerated. Likewise, if the change order contains a specified time extension and the contractor does not object to its length, the contractor will probably be contractually precluded from later asserting that it was entitled to a lengthier time extension.

To avoid the dangers of waiving an additional time extension, the contractor should give the owner written notice of all time extensions it is claiming. If the contractor feels it is being accelerated because it has been granted an inadequate time extension, the contractor should give the owner written notice that it considers the time extension inadequate and that it will expect additional compensation for its acceleration effort.

Finally, if the contractor chooses to execute any change orders, the contractor should expressly reserve in the change order its right to seek additional time extensions and to bring a claim to recover any additional costs it incurs. Such express reservations of rights will support a contractor's subsequent claim for acceleration costs.<sup>102</sup>

In sum, if the court finds either that the time extension was sufficient to compensate the contractor for the delay or that the contractor waived any additional time extensions, then the court will not grant a constructive acceleration claim.<sup>103</sup> On the other hand, if the court finds that the time extension was inadequate and the contractor did not waive the additional time extensions to which it was entitled, then the court will find that the contractor was constructively accelerated.<sup>104</sup>

#### [5] Acceleration Efforts and Costs

When a contractor is constructively accelerated, the contractor must prove that it incurred costs as a direct result of its acceleration efforts.<sup>105</sup> As an initial matter, the contractor must demonstrate that it actually accelerated its work.<sup>106</sup> Although this requirement appears self-evident, acceleration claims have been denied because the contractor failed to offer sufficient proof that it took steps to accelerate the work.<sup>107</sup> Likewise, there must be a causal link between an owner's directive and the contractor's efforts to accelerate, and a constructive acceleration claim will be

<sup>102</sup> GEM Eng'g Co. v. Department of Commerce, GSBCA No. 13566-COM, 97-1 B.C.A. (CCH) ¶ 28,637 (1997).

<sup>103</sup> See, e.g., Essential Constr. Co., ASBCA No. 189,706 89-2 B.C.A. (CCH) ¶ 21,362 (1989).

<sup>104</sup> See, e.g., E.C. Ernst Co. v. Koppers Co., 626 F.2d 324 (3d Cir. 1980).

<sup>105</sup> See Nat Harrison Assocs. v. Gulf States Utils. Co., 491 F.2d 578, 587 (5th Cir. 1974); Hemphill Contracting Co., ENGBCA No. 5698, 94-1 B.C.A. (CCH) ¶ 26,491 (1993).

<sup>106</sup> R.C. Hedreen Co., ASBCA No. 21695, 78-2 B.C.A. (CCH) ¶ 13,254 (1978).

<sup>107</sup> See, e.g., Associated Indus. Contracting, Inc., ENGBCA No. 5370, 88-2 B.C.A. (CCH) ¶ 20,708 (1988).

denied if a contractor accelerates its work to meet its own objectives.<sup>108</sup> However, a contractor need not prove that its acceleration efforts successfully completed the project within the times specified by the owner. Rather, a contractor must only show that it made reasonable efforts to accelerate as a result of the owner's actions.<sup>109</sup>

The last element of a constructive acceleration claim is proof that the constructive acceleration caused the contractor to incur additional costs. As will be discussed in this chapter, acceleration damages typically include costs for premium time and overtime work, loss productivity, additional equipment and material costs, and overhead. No matter what costs are claimed, a contractor must demonstrate that it incurred additional costs as a result of the acceleration.<sup>110</sup> Also, a failure to satisfactorily prove these costs may result in the denial of an otherwise valid acceleration claim.

#### [D] Effect of No Damages for Delay Clauses

Like other business transactions, a party's rights and remedies related to a construction project are often defined by the contract. As such, parties are generally free to limit their liability for damages arising from the other party's actions. For example, some construction contracts may contain "no damages for delay" clauses that preclude recovery from damages resulting from delay. If a contract contains a "no damages for delay" clause, the owner may argue that a contractor is barred from recovering acceleration damages, even if a contractor successfully proves all elements of an acceleration claim.

Absent certain exceptions, courts have held that "no damages for delay" clauses are enforceable to preclude delay damages. Such damages may include costs for stopping work, remobilization, idle equipment, and extended home office overhead. However, it is unclear whether "no damages for delay" clauses also apply to bar acceleration damages. Some courts distinguish between delay and acceleration damages, and therefore find that such clauses do not affect acceleration claims.<sup>111</sup> Other courts, however, have held that "no damages for delay" clauses apply equally to claims for acceleration costs.<sup>112</sup>

#### [E] Demonstrating Acceleration of a Project

The contracting parties' expectations influence directly how those parties to the construction process view project performance. With an acceleration claim, as in any claim, the fundamental question to address is whether the contractor's

<sup>108</sup> Earth Tech Indus., Ltd, ASBCA No. 46450, 99-1 B.C.A. (CCH) 30,341 (1999).

<sup>109</sup> See, e.g., Fermont Div., Dynamics Corp. of Am., ASBCA No. 15806, 75-1 B.C.A. ¶ 11,139 (1975); Varo, Inc., ASBCA No. 15000, 72-2 B.C.A. (CCH) ¶ 9717 (1972).

<sup>110</sup> See Danac, Inc., ASBCA No. 33394, 97-2 B.C.A. (CCH) ¶ 29,184 (1997); Earth Tech Indus., Ltd, ASBCA No. 46450, 99-1 B.C.A. (CCH) 30,341 (1999).

<sup>111</sup> See Nat Harrison Assocs., Inc. v. Gulf States Utils. Co., 491 F.2d 578 (5th Cir. 1974).

<sup>112</sup> See Siefford v. Housing Auth., 192 Neb. 643, 223 N.W.2d 816 (1974).



performance (including its expenditure of both physical and financial resources) was different from that originally anticipated. Acceleration claims are especially sensitive to the time element in a contract. The term acceleration implies that project events occurred sooner or in a shorter time frame than anticipated, or that additional contractor effort was expended to meet the expectations of the original schedule.

To present a successful acceleration claim, a contractor must show that it accelerated its performance. If the contractor cannot demonstrate an acceleration effort, in effect there are no damages. On the other hand, if the contractor can successfully show that its performance was on or ahead of a properly adjusted schedule at the time of an actual or constructive acceleration directive, the contractor has taken the first step in presenting an acceleration claim. Thus, analysis of the project schedule is an imperative first step in proving an acceleration claim.

In an actual acceleration case, a contractor must be able to show when completion was required under the contract and must be able to prove that it completed or attempted to complete ahead of that due date. For a claim of constructive acceleration, the contractor also must establish that there was an event that caused its performance to be excusably delayed. There are a number of ways in which a contractor can prove acceleration. However, a preferred method for proving acceleration claims is to analyze the project schedules.

### [1] Project Schedules

The sophistication involved in the contractor's management of the construction schedule often depends on the size of the construction project. Today most contractors use some form of Critical Path Method (CPM) scheduling for managing and assessing project performance with respect to time. A CPM is admirably suited to the construction industry, because it provides a far more useful and precise approach than the conventional bar graphs and progress charts that previously formed the basis of construction planning and control.<sup>113</sup> The effective management of a construction project, as well as the successful presentation of an acceleration claim, turns on the analysis of the project schedule.

CPM can be described as a graphic presentation of the planned sequence of activities that shows the interrelationships and interdependencies of the elements composing a project.<sup>114</sup> The Corps of Engineers Board of Contract Appeals provided its own definition of CPM in *Continental Consolidated Corp.*<sup>115</sup> This definition is significant, not just for its recitation of basic network principles, but also for its recognition that CPM is a dynamic concept that changes during the life of the project

<sup>113</sup> See *American Sanitary Sales Co. v. State*, 178 N.J. Super 429, 433, 429 A.2d 403, 405 (1981).

<sup>114</sup> For a detailed discussion of network planning principles and the history of their development, see J. O'Brien, *CPM in Construction Management* (3d ed. 1984); Moder & Phillips, *Project Management with CPM and PERT* (2d ed. 1970); J. Fondahl, *Handbook of Construction Management and Organization* (1973).

<sup>115</sup> ENGBCA Nos. 2743, 67-2 B.C.A. ¶ 6624 (1967).

and should be properly adjusted to reflect time due the contractor concurrent with events on the project:

The CPM scheduling technique is one which requires a breakdown of the entire project into individual tasks and an analysis of the number of days required to perform each task. The analysis is then programmed into a computer which produces a chart showing the tasks and a line which controls the completion of the overall work. The line through the nodes, the junction point for completion of essential tasks, is known as the critical path. In addition, there are numerous side paths for subordinate tasks which normally can be performed without affecting the critical path. However, these subordinate tasks[,] if improperly scheduled or unduly delayed in performance, can on occasions become critical and thus change the critical path for the entire project.

The critical path method of scheduling requires the logical analysis of all the individual tasks entering into the complete job and the periodic review and re-analysis of progress during the performance period. It is essential that any changes in the work and the time extensions due to the contractor be incorporated into the progress analysis concurrently with the performance of the changes or immediately after the delay and thus integrated into the periodic computer runs to reflect the effect on the critical path. Otherwise, the critical path chart produced by the computer will not reflect the concurrent status of work performed or the actual progress being attained.

A CPM permits the ready evaluation and comparison of alternative work programs, construction methods, and types of equipment. The critical path diagram depicts construction operations that control timely and efficient execution of the work. Finally, as construction proceeds, the diagram provides precise information on the effects of each variation or delay in the adopted plan, enabling identification of the operations that require remedial action.<sup>116</sup> CPM schedules can be created using either precedence or activity on arrow logic, that is, representing the activities by arrows and the relationships between them by nodes or points of intersection.

The initial step in using the critical path method to identify an acceleration effort is to prepare a "as-planned" (baseline) CPM schedule. This requires determining the work activities of the construction project and ascertaining the logical relationships among the activities. A *work activity* on a construction project is defined simply as a time-consuming task with a recognizable beginning and end.<sup>117</sup> It is up to the owner and contractor on each construction project to determine the length and size of each designated work activity. While there are no set rules, the contract's scheduling specification often provides guidance or constraints pertaining to the acceptable number and duration of activities.

The as-planned CPM schedule can be displayed in the form of a network diagram or flowchart. The diagram is a pictorial display of the job's logic that charts from left to right the sequence and dependencies of events. When the CPM schedule

<sup>116</sup> *Id.*

<sup>117</sup> M. Callahan & H. Hohns, *Construction Schedules* 12 (1983).



system. Others address potential delays through risk shifting provisions, such as liquidated damages, "no damage for delay" clauses, scheduling and record keeping requirements, and unit cost line items for extended performance costs. Still others, assuming delays are inevitable, attempt to manage the impact of delays through alternate dispute resolution and partnering. Frequently, all three methods are used.

Regardless of how an owner attempts to manage risk, it should keep in mind that courts prefer the burden of risk to lie with those most able to manage it. In terms of project delays, the owner can influence the time of performance through its contracts and the decisions it makes during design and construction. Architects can control delays through the complexity of their design and the performance of construction phase services. General contractors and construction managers manage delays through scheduling, implementing their means and methods of construction, and directing their subcontractors and suppliers. Because the owner, architect, and contractor exert varying degrees of control over the progress of work, courts generally respect contract language assigning risk in the context of delay litigation.

Given the import that contractual agreements have in evaluating delays, the most critical decisions an owner faces in managing potential delay claims are those that are made before any design or construction work is attempted. Owners typically decide what project delivery system will be used and select the owner's representative, architect, contractor, and construction manager. These decisions, and the role each party assumes during the design and construction phases of the work, can significantly influence an after-the-fact assessment of any delay claim.

Similarly, the terms of contractual agreements the owner uses for designing, managing and building a project impact the owner's position in assessing responsibility for future delays. To protect its interests, the owner should negotiate provisions that establish the time of performance, allocate risk associated with potential delays, exculpate the owner from liability (especially those risks over which the owner has no control),<sup>1</sup> and assist in prosecuting claims when delay cannot be avoided (such as liquidated damages clauses tied to specific construction milestones).

Emphasis also should be placed on the scheduling specification itself. Requiring a contractor to submit a critical path method (CPM) schedule and periodic updates in an electronic format help the owner and its representatives monitor progress and identify potential delays as they occur. Cost and/or resource-loaded CPM schedules can further assist the owner in these areas and help the owner in reviewing progress payment requests. In terms of owner delay claims, these types of requirements are a useful baseline for measuring as-built activities versus planned activities. They also assist the parties in ascertaining the extent and cause of a delay. To do this effectively, the owner must have the most accurate, up-to-date informa-

<sup>1</sup> See, e.g., *Corinno Civetta Constr. Corp. v. City of New York*, 493 N.E.2d 905, 909-10 (N.Y. 1986) (holding that "no-damage-for-delay" clauses do not violate public policy); *S. Leo Harmonay, Inc. v. Binks Mfg.*, 597 F. Supp. 1014, 1026 (S.D.N.Y. 1984) (finding contractor liable to subcontractor for delay when contract terms specifically forbade such a delay).

tion from the site. Section 9.04 will discuss effective ways for the owner to stay informed.

The scope of work also should be evaluated to identify likely causes of delay when the contract documents are negotiated. For example, some delays are common to any construction project. These include delays in delivery of essential materials and equipment; insufficient manpower, out-of-sequence work, inefficient work, errors in plans and specifications, change orders, late delivery of shop drawings and submittals, multiple resubmissions to correct errors in shop drawings and submittals, delays by the architect or engineer in approving shop drawings, defaults or insolvency of contractors or subcontractors, and ineffective construction management. Other predictable causes for delay are unique to a specific project. For example, the renovation of an existing, occupied building may involve delays caused by unforeseen conditions in the existing structure or the inability to relocate tenants or other occupants from the site in a timely fashion. In contrast, a new construction project can be delayed by unforeseen subsurface conditions that are not likely to impact a renovation project. All of these issues should be considered at the outset of the project and monitored throughout construction.

## § 9.03 RISK ALLOCATION STRATEGIES

### [A] Project Delivery Systems

As noted above, the owner's choice of project delivery delivery can significantly impact its ability to manage delays and pursue delay claims. The project delivery system defines the hierarchies and legal relationships among the parties. In terms of delay, these definitions are important because the delivery system determines who controls critical elements of construction and, therefore, establishes the rights and obligations of the parties if the project is delayed. Therefore, among the many factors an owner must consider in choosing a project delivery system is how the system allocates risk.

#### [1] Design-Bid-Build

The most common form of project delivery in the United States is "design-bid-build." On a traditional design-bid-build project, the owner enters into separate contracts with an architect to design the project and a general contractor or construction manager (CM) to build what the architect has designed. Under the owner/architect agreement, the owner conveys to the architect its needs, program requirements and expectations regarding schedule, scope of work, and budget. In return, the architect designs the project, delivering completed drawings and specifications. The completed drawings and specifications are released to several contractors for bids or proposals.

The construction contract can be awarded on the basis of a low bid or under a negotiated "best value" approach. Under the owner/contractor agreement, the



contractor is generally responsible for scheduling, providing labor, material, and equipment to complete the work, and controlling the means and methods of construction. The contractor also is required to coordinate its subcontractors and suppliers and will be responsible for any work its subcontractors or suppliers perform.

The owner's role during the construction of a design-bid-build project can be active, if the owner chooses to oversee the work itself, or limited, if the owner relies on the architect or a consultant (such as a CM) to serve as its project representative. The more control the owner retains in overseeing construction activities, the greater the risk that the owner will be held responsible for delays. Therefore, many owners shield themselves from liability by retaining consultants to approve shop drawings, review payment applications, interpret the drawings and specifications, and monitor the quality and timeliness of the contractor's work.

With regard to delay claims, design-bid-build provides the owner with the option of seeking damages from the architect, contractor, and/or construction manager. In simple terms, the architect will be responsible for delays that are caused by design errors, the contractor will be responsible for construction related delays, and the CM will be responsible for oversight errors. Of course, the rights and obligations of these parties frequently overlap. Therefore, allocating liability for project delays under the design-bid-build model can be complicated.

A fundamental difficulty in allocating liability under the design-bid-build model is the inherent tension between the interests of the architect and contractor. Some contractors believe they can increase profits through change orders that are based on ambiguities, errors, or omissions in the architect's design. Architects have an interest in protecting their designs and frequently serve as the owner's representative during construction. In these situations, it benefits the architect to resist any suggestion that the design is flawed and deny change order requests based on defective plans and specifications.

Because of these competing interests, it can be difficult for the owner to determine whether the architect or contractor is responsible for a delay. The owner is essentially caught in the middle. If the owner pursues a claim against the contractor, it will be forced to defend architect's design. If the owner pursues a claim against the architect, it will be required to make allegations regarding the design that the contractor can use to establish a delay claim against the owner. To complicate matters further, it may not be possible to join the architect and contractor in a single action to let these matters be revealed in a common forum.

Another complication for the owner under the design-bid-build model is the burden of proof in a malpractice action against an architect. In general terms, the architect is required to design the project using the degree of skill that is ordinarily exercised by a similarly situated design professional.<sup>2</sup> Under this standard, the architect's drawings and specifications are not expected to be perfect. Therefore,

<sup>2</sup> Saint Rita's Home, Inc. v. Town of Amherst, 327 N.Y.S.2d 674 (App. Div. 1972).

certain conflicts, including those which result in a delay, may not support a claim by the owner against the architect. This is a problem because owners typically warrant the sufficiency of the design they provide to the contractor. Therefore, the owner may be required to compensate the contractor for design errors for which the owner cannot seek recovery from the architect.

Despite these problems, there are many advantages to the design-bid-build project delivery system that are not available under alternative models. In terms of owner delay claims, the most significant benefits are the control the owner retains over the project's design and the owner's ability to rely on the architect to protect the owner's interests in the event of a delay. The owner should be aware of these issues in deciding to use the design-bid-build project delivery system. Care also should be taken to address known risks in the contract documents.

## [2] Design-Build

To avoid problems associated with the divergent interests of the architect and contractor under the design-bid-build model, some owners attempt to create a single point of responsibility by using the design-build delivery system. As the name implies, the design-build model contemplates that the owner will contract with a single entity to both design and build the project. Under an owner/design-builder contract, the owner conveys its needs, program requirements, completion date, and budget. In return, the design-build contractor agrees to design and construct the project for a stipulated sum (or cost plus a fee) and to complete the project by a certain date.

In theory, the owner assumes fewer delay risks under a design-build contract because a single entity controls both design and construction. Regardless of whether a delay is caused by a design error or a construction problem, the owner should have a right of action under a design-build agreement. Many owners also believe it is easier and less expensive to prove a delay claim against a design-build contractor than a general contractor or architect because it is not necessary to trace the cause of delay to a specific design element or construction event. Design-build also is attractive to owners because they feel they will be exposed to fewer claims.

However, the owner's ability to pursue a delay claim against a design-build contractor is not always as simple as it appears. Owners frequently (and unwittingly) retain control of certain delay risks despite their efforts to have a single point of responsibility. In this regard, design-build contractors have defeated owner delay claims where the owner mandated certain elements of the design through its design parameters or the owner changed elements of the design-build contractor's plans and specifications during the review and approval process.<sup>3</sup> Ironically, in either situation, the design-build contractor may be in a position to pursue an affirmative delay claim against the owner. Similarly, the design-build contractor can attempt to

<sup>3</sup> See, e.g., *Armour & Co. v. Scott*, 360 F. Supp. 319 (W.D. Pa. 1972), *aff'd*, 480 F.2d 611 (3d Cir. 1973).



In most non-statutory, multi-prime states, owners may delegate the responsibility for coordinating work performed by the various trade contractors. Obviously, it is easier for the owner to pursue delay claims in this situation because it has shifted the duty to achieve the desired completion date to a third-party contractor. Courts in these states typically use a fact-based approach to evaluate a defense of delegation.<sup>6</sup> Of primary interest to these courts is the degree to which the owner exercises coordination among the primes. There is no consensus on how courts treat these issues. Courts around the country have used different tests and weighed facts differently. Therefore, owners should seek contractual terms that aid in their desired risk allocation. A clear understanding of the delegation standard in the state where the project is located is essential. Delay claims are endemic to the multi-prime context, and the owner must understand its exposure to claims before executing any agreements.

The most common way to delegate the duty to coordinate in a multi-prime environment, is to appoint one of the primes as the lead contractor, and contractually charge them with coordinating the activities of the other contractors. Such "coordinating" contractors can differ significantly from traditional general contractors. Depending upon the language of the contract, the coordinating contractor may have little or no authority over the contractors they are assigned to coordinate. In these situations, courts again diverge.

Even if the owner has delegated some authority to one of the multiple primes, an owner who hopes to avoid liability for negligent supervision should refrain from undertaking coordinating activities. In *Broadway Maintenance Corp. v. Rutgers State University*,<sup>7</sup> Rutgers, the owner, contractually delegated site management responsibilities to one of its prime contractors. However, Rutgers did not grant the coordinating contractor power to terminate or stop payment on the other prime contracts. A delay by one of the other prime contractors resulted in damages, and the remaining primes sued the owner. The court found Rutgers's delegation to be effective, stating that the University "did not alter its expressed intent to have someone else supervise the job . . . [Rutgers] never intervened to coordinate the operations. It never assumed control."<sup>8</sup> The behavior of the owner was consistent with its intention to remain apart from the site operations, and this was sufficient to free him from liability for delay. The holding also clearly implies the reverse: Had Rutgers interfered with, or involved itself in the coordination of the site, it risked being responsible for the entire duty of coordination, and the liability that arises from it.<sup>9</sup>

<sup>6</sup> *Georgia Power Co. v. Georgia PSC*, 396 S.E.2d 562, 573 (Ga. App. 1990) ("There is general agreement that the factual circumstances presented in construction cases are so varied that each case must be determined on its particulars").

<sup>7</sup> 447 A.2d 906 (N.J. 1982).

<sup>8</sup> *Id.* at 913.

<sup>9</sup> *Id.* at 915. See also *Natkin & Co. v. George A. Fuller Co.*, 347 F. Supp. 17 (W.D. Mo. 1972) (holding owner responsible for delays, because his interference with work amounted to assuming control thereof).

Some courts have refused to allow owners to evade coordination obligations through simple inaction, and have held that coordinating contractors must have some ability to enforce their instructions. To these courts, delegation is impossible unless owners cede some measure of contractual authority to the coordinator.<sup>10</sup>

Another common clause in a multi-prime agreement places a duty on the contractor to work in cooperation with the other contractors involved in the project. Such a clause, if repeated in all of the contracts between the primes and the owner, may be seen to create a duty of cooperation among the primes independent of any supervisory duty of the owner. This theory has met with a mixed, mainly negative, reception. Some courts have held that this duty may be accepted by the primes, and they will be held responsible for delays that proceed from poor coordination on the site.<sup>11</sup> However, the majority of courts hold that such a clause does not shift the duty of oversight from the shoulders of the one most able to bear it. The owner "has the duty to invoke contractual rights to compel cooperation among contractors."<sup>12</sup>

Owners contemplating the multi-prime approach to construction, or who are obligated to adopt it by state statute, should determine the extent of their coordination role in advance, and make specific delegations within the contract documents.

## [B] Contract Provisions

### [1] Generally

In the absence of specific contractual risk-shifting provisions, courts typically allocate responsibility to the party most able to control a given risk. Rather than relying on the courts to determine who will be responsible for a given risk, most owners allocate risk through contractual agreements. This is done through contract provisions that establish (1) categories of delay for which no party will be responsible (the typical *force majeure* circumstances, discussed in § 9.08);<sup>13</sup> (2) interim milestone completion dates that, if missed, trigger liquidated damages; (3) causes of delay for which persons other than the owner will be liable; and (4) risk allocation for delay caused by events that are unique to the specific project. Examples of these types of provisions can be found in standard contracts published by the American Institute of Architects, Associated General Contractors of America, and other industry groups. These types of provisions also are mandated on federal government contracts and most state and local contracts as well.

<sup>10</sup> See *Tippetts-Abbott-McCarthy-Stratton v. New York Thruway Auth.*, 212 N.Y.S.2d 263 (Ct. Cl. 1961).

<sup>11</sup> See, e.g., *CIG Contractors v. Miss. State Bldg. Comm'n*, 510 So. 2d 510 (Miss. 1987) (holding that a provision requiring cooperation was enough to exculpate the owner).

<sup>12</sup> See, e.g., *Shea-S & M Ball v. Massman-Kiewit-Early*, 606 F.2d 1245, 1251 (1979) (reversing lower court's finding that clause requiring cooperation exculpated owner).

<sup>13</sup> See *General Conditions of the Contract for Construction*, American Institute of Architects, Doc. No. A201-1997, § 8.3.1 (1997).



i.e., a promise by all contractors and subcontractors that they will not seek to recover delay damages, from the owner, regardless of the cause. Although “no damage for delay” provisions are generally enforceable, there are exceptions to their enforcement. The majority of jurisdictions that have evaluated these provisions have outlined four general exceptions:

Generally, even with such a clause, damages may be recovered for: (1) delays caused by the contractee’s bad faith or its willful, malicious, or grossly negligent conduct, (2) unanticipated delays, (3) delays so unreasonable that they constitute an intentional abandonment of the contract by the contractee, and (4) delays resulting from the contractee’s breach of a fundamental obligation of the contract.<sup>18</sup>

If a contract includes an enforceable “no damage for delay” clause, the owner is not at liberty to cause such delays to serve its purpose. The owner is, however, insulated from such delays as arise from simple negligence, a standard lower than the bad faith/unreasonability exception outlined above.<sup>19</sup> Strategically, an owner is in a better position to negotiate delay claims against a contractor if the contractor is contractually barred from asserting a delay claim against the owner.

#### [6] Notice and Record Keeping

Two other valuable tools for managing risk and developing owner delay claims are strict notice and record keeping requirements. Most owners require contractors to provide written notice of any event that can cause a delay to the project within a specified time period from the date the cause of the delay was known to the contractor. Contractors also are frequently required to identify the cost and time impacts of a delay within a limited timeframe.<sup>20</sup> The enforceability of such provisions varies depending on the circumstances, the terms of the contract, and applicable law.

This type of notice is valuable because it gives the owner an opportunity to contemporaneously investigate the cause of delay and minimize its impact. Notice also places the owner in a position to assess responsibility for the delay and develop claims of its own. Early notice is particularly important if the contractor is responsible for a critical path delay and submits delay claims to the owner to cover its mistakes.

The types of records a contractor maintains and submits to the owner also are helpful in determining who is responsible for project delays. Considering the inherent proof problems in both the liability and damages elements of delay claims, retention of records and documentation is crucial. The owner should specify what

<sup>18</sup> United States ex rel. Evergreen Pipeline Constr. Co. v. Merritt Meridian Constr. Co., 95 F.3d 153, 167 (2d Cir. 1996), quoting *Corinno*, 493 N.E.2d at 910.

<sup>19</sup> *Id.*

<sup>20</sup> See, e.g., Federal Acquisition Regulation 52.243-4(b)-(e); *General Conditions of the Contract for Construction*, American Institute of Architects, Doc. No. A201-1997, § 4.3.2 (1997). See also Stephen B. Shapiro, *Notice of Claims*, in *Construction Claims Deskbook* (R. Brams & C. Lerner eds., Aspen Law & Business, 1996).

records the contractor is required to submit to the owner during the course of the project (see § 9.04, below). The owner also should consider mandating the types of daily reports, time records, cost records, and schedule submissions that are used. While the contractor may increase its bid or proposal to cover increased record keeping requirements, having appropriate daily reports, contemporaneous fragments for delays and coded time records can help manage or eliminate risks.

Be aware that sophisticated contractors have been successful in using these types of records to develop claims against the owner. Therefore, all contractor records should be shared with the owner during the project. The owner should maintain its own project records to ensure an accurate record of what occurred during the project.

#### [7] Allocating “Float Time”

A very controversial method of controlling responsibility for delay is through the allocation of so-called float time. Float represents “the amount of scheduling discretion or flexibility that may be available for that activity before total project duration will be adversely affected.”<sup>21</sup> Absent a specific contractual agreement to the contrary, float time is treated as “an expiring resource available to all parties on the project on a nondiscriminatory basis so long as they act in good faith.” In other words, any float in the schedule can be used by whoever gets to it first. Many owners and contractors formalize this understanding by including a contract clause to this effect.<sup>22</sup>

This standard allocation of float reflects the mutual understanding that the contractor is often in the best position to alter the disposition of his forces and resources, rather than attempting to obey by rote a schedule that events have overtaken.<sup>23</sup> An owner can reduce its risk of liability for delay, and enhance its ability to recover delay damages, by taking “ownership” of float. If this is done, the contractor will be responsible for any self-imposed delays in the schedule, regardless of whether the delay is on the critical path of the construction schedule. This type of provision is controversial and, therefore, rarely used. If the owner contractually assumes ownership of float in the construction schedule, concurrent causes of delay can make float time a prized and much contested asset.

#### [C] Partnering

Another pre-construction measure that can indirectly influence future delay is *partnering*. Partnering is a more or less formal commitment by all concerned parties on a project to implement and use a forum that provides opportunities for open communications between the parties on a regular basis to achieve joint resolution

<sup>21</sup> *Blinderman Constr. Co. v. United States*, 39 Fed. Cl. 529, 580 (1997).

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*, citing *Harry & Keith Mertz Constr. Co. Inc.*, ASBCA Nos. 94-165-1, et al., 97-1 BCA p. 28,802.



of time to afford a basis of estimation with some degree of certainty as to the probable loss of profits, but that, on the other hand, loss of profits from a business which has not gone into operation may not be recovered because they are merely speculative and incapable of being asserted with the requisite degree of certainty.<sup>40</sup>

Courts have expanded the new business rule. The current trend is to follow the principle that the novelty of a business only affects the reasonable certainty of the lost profits. Furthermore, the question of whether the lost profits can be proven with reasonable certainty is a question of fact left for the jury.<sup>41</sup> This switch from a per se rule to a "reasonably certain" evidentiary standard has been accepted, to varying degrees in most jurisdictions.<sup>42</sup>

Many courts have been willing to award lost profits for new businesses when the lost profits can be proven with reasonable certainty. In *AGF, Inc. v. Great Lakes Heat Treating Co.*,<sup>43</sup> the Ohio Supreme Court agreed that:

lost future profits are difficult for a new business to calculate and prove, we are persuaded that there should be no per se rule against the award of such damages where they may be shown with the requisite degree of certainty. Accordingly we hold, along with what appears to be a majority of jurisdictions reaching the issue, that the new business rule is not the law of our state.<sup>44</sup>

Additionally, courts have expanded on the reasonably certain requirement. In *Travelers Int'l A.G. v. Trans World Airlines*,<sup>45</sup> the court held that the fact a business was new, while not creating a per se ban on the recovery of lost future profits, did invoke an evidentiary rule with a separate "level of proof needed to achieve reasonable certainty as to the amount of damages."<sup>46</sup> The Supreme Court of Ohio has even suggested methods by which a plaintiff's reasonable certain standard may be met. They held that "damages may be established with reasonable certainty with the aid of expert testimony, economic and financial data, market surveys and analyses, business records of similar enterprises, and the like."<sup>47</sup>

<sup>40</sup> See *id.* at 904.

<sup>41</sup> See Robert L. Dunn, *Recovery of Damages for Lost Profits*, § 4.2 (3d ed. 1987); *In re Merritt Logan, Inc.*, 901 F.2d 349 (3d Cir. 1990); *Drews Co., Inc. v. Ledwith-Woffe Assocs., Inc.*, 371 S.E.2d 532, 534 (S.C. 1988); *W.W. Gay Mechanical Contractor, Inc. v. Wharfside Two, Ltd.*, 545 So. 2d 1348, 1351 (Fla. 1989).

<sup>42</sup> See *Drews Co., Inc. v. Ledwith-Woffe Assocs., Inc.*, 371 S.E.2d 532, 534 (S.C. 1988) (listing decisions in various jurisdictions; all accepting the "reasonably certain" standard in determining lost profits for an unestablished business: *Chung v. Kaonohi Center Co.*, 618 P.2d 283 (Haw. 1980); *Welch v. U.S. Bancorp Realty and Mortgage*, 596 P.2d 947 (Or. 1979); *Fera v. Village Plaza, Inc.*, 242 N.W.2d 372 (Mich. 1976); *Smith Dev. Corp. v. Bilow Enters., Inc.*, 308 A.2d 477 (R.I. 1973); *S. Jon Kredman & C. v. Meyer Bros. Parking-Western Corp.* 58 Cal. App. 3d 173 (1976)).

<sup>43</sup> 51 N.E.2d 634, 639 (Ohio 1990)

<sup>44</sup> See *id.* (quoting *Drews Co. v. Ledwith-Wolfe Assocs.*, 371 S.E.2d 532, 534 (S.C. 1988))

<sup>45</sup> 41 F.3d 1570 (2d Cir. 1994) (followed by *International Telepassport Corp. v. USFI, Inc.*, 89 F.3d 82, 86 (2d Cir. 1996)).

<sup>46</sup> *Id.* at 1579.

<sup>47</sup> See *AGF, Inc. v. Great Lakes Heat Treating Co.*, 51 N.E.2d 634, 638 (Ohio 1990).

## [D] Mitigation of Damages

Aside from attempting to disprove one of the three required elements, the defendant may choose to file an affirmative defense or a counter-claim asserting that the plaintiff did not mitigate its damages.<sup>48</sup> As a general rule, "recovery will not be allowed for damages that a party should have foreseen and could have avoided by reasonable effort without undue risk, expense, or humiliation."<sup>49</sup> If a party fails to mitigate its damages, it may not maintain a claim against another for those same damages.<sup>50</sup>

In *R.E.T. Corp. v. Frank Paxton Co., Inc.*,<sup>51</sup> the Supreme Court of Iowa affirmed a lower court's decision finding the builder's negligent installation of insulation material the proximate cause of the plaintiff's damages. In doing so, the court also addressed the issue of mitigation. The court held that a plaintiff's duty in mitigation is one of "reasonable diligence."<sup>52</sup> The court further stated that this was an issue of fact and, in denying the defense claim, held that "a lack of sufficient funds" was a sufficient reason to "excuse an absence of effort to lessen damages."<sup>53</sup>

## § 12.02 CONTRACT DAMAGES

Contract damages are the general form in which claims for lost profits are established. In turn, lost profits from a breach of contract are separated into two distinguishable classes, general damages (also called direct damages) and special damages (also called collateral damages).<sup>54</sup> Specifically, these two categories have been described as:

1. General damages—"lost profits which are direct damages and represent the benefit of the bargain (such as a general contractor suing for the remainder of the contract price less its saved expenses),"<sup>55</sup> and

<sup>48</sup> See *Iowa Power & Light Co. v. Board of Water Works Trustees*, 281 N.W.2d 827, 833 (Iowa, 1979) ("the defense of mitigation (or avoidable consequences) must be both pled and proven by the asserting party").

<sup>49</sup> *MLK, Inc. v. University of Kansas*, 940 P.2d 1158, 1165 (Kan. 1997) (quoting *First Nat'l Bank v. Milford*, 718 P.2d 1291 (Kan. 1986)).

<sup>50</sup> See *Graphic Assoc., Inc. v. Riviana Restaurant Corp.*, 461 So. 2d 1011 (Fla. 1984); *Barry & Sewall Industrial Supply Co. v. Metal-Prep of Houston, Inc.*, 912 F.2d 252, 259 (8th Cir. 1990).

<sup>51</sup> 329 N.W.2d 416 (Iowa, 1983).

<sup>52</sup> See *id.* at 422; see also *Whewell v. Dobson*, 227 N.W.2d 115, 120 (Iowa 1975); 22 Am. Jur. 2d, *Damages* §§ 32-33 at 53-57 (1965); 25 C.J.S. *Damages* §§ 96-97 at 1000-04 (1966).

<sup>53</sup> *R.E.T. Corp. v. Frank Paxton Co., Inc.*, 329 N.W.2d at 422 (concurring with the trial court's denial of the defense claim that the plaintiff failed to mitigate where the plaintiff's evidence showed that it took two years to verify the source of the problem, find a solution, and secure funds to pay for the eventual fix).

<sup>54</sup> See *Imaging Sys. Int'l, Inc. v. Magnetic Resonance Plus, Inc.*, 490 S.E.2d 124, 127 (Ga. 1997).

<sup>55</sup> *Id.*



2. Special damages—"lost profits which are indirect or consequential damages such as what the user of the [product] would lose if the [product] were not working and he was unable to perform . . . services."<sup>56</sup>

In *Imaging Systems International, Inc. v. Magnetic Resonance Plus, Inc.*,<sup>57</sup> the Court of Appeals of Georgia held, after distinguishing both special and general damages, that a clause in the contract at issue, stating that "any" lost profits could not be recovered, acted to prohibit the collection of both special and general damages. In this specific circumstance the contract was silent as to the "type" of lost profits referenced by the contract. The court stated that where no specific delineation was provided in the contract, the term "any lost profits" could be used to exclude both special and general lost profits.

The court further held that "[a]bsent public policy interest, contracting parties are free to contract to waive numerous and substantial rights, including the right to seek recourse in the event of a breach by the other party."<sup>58</sup>

#### [A] General Damages

General damages are defined as damages arising directly out of the contract. Specifically, as to lost profits, these are profits that the plaintiff would have received had the contract been performed as the parties intended. In *Channel Dry, Inc. v. Haver*,<sup>59</sup> this was quantified as "the contract price for full performance reduced only by the amount that defendant's breach saved plaintiff."<sup>60</sup> General damages are different than special damages, which are collateral to the contract.

In principle, it is easier to show that general damages are reasonably foreseeable (to the contracting parties) because they are directly related to the contract. Whereas, with specific damages, there is usually no documentation that pertinent issues were contemplated by the parties. In fact many courts define "foreseeable" as issues directly related to the agreement signed by the parties.

Typically, the plaintiff's general damages are attached to activities concurrent to the defendant's breach. The plaintiff, in turn has an expectation that it will be compensated for the immediate losses suffered due to the defendant's actions. Future losses, on the other hand, are generally speculative and subject to separate proof requirements.<sup>61</sup>

However, future lost profits are occasionally classified as general damages. In these circumstances the plaintiff has future damages because the defendant has breached an ongoing agreement that has both caused immediate damages and

<sup>56</sup> *Id.*

<sup>57</sup> 490 S.E.2d 124, 127 (Ga. 1997).

<sup>58</sup> *Id.*

<sup>59</sup> 590 N.E.2d 868 (Ohio 1990)

<sup>60</sup> *Id.* at 872.

<sup>61</sup> See § 12.01[C], *supra*.

disabled the plaintiff from realizing future profits. The typical situation where this arises is a long-term lease agreement. As a rule, where the defendant breaches a long term lease, courts have been willing to allow plaintiffs to receive profits, that are "supported by the evidence,"<sup>62</sup> up through the end of the lease period.<sup>63</sup>

#### [1] Liquidated Damages

Liquidated damages are general damages that are specifically defined within the contract.

When parties agree to a liquidated damage clause, they are agreeing in advance to a formula for computing damages in the event of a breach. Generally liquidated damages address delays in completion by the contractor and are payable to the owner on the basis of a per diem assessment. However, a contractor could agree to a similar contract clause with a subcontractor, making the penalty payable based on a delayed delivery by the subcontractor.

It is important to note that liquidated damages may not be assessed as punishment against the party causing delay/lost profits. The measure of damages must have been "chosen because of difficulties in proving the certainty of damages that would be incurred and whether the stipulated sum was agreed to as a good faith pre-estimate of actual damages."<sup>64</sup> Whether or not this standard is met by the parties is a "mixed factual and legal question."<sup>65</sup>

#### [2] Contractual Right to Terminate Work

Frequently a contract will contain a clause that allows a party to terminate work upon the occurrence of a specific event. This right, however, generally does not absolve a party from compensating another for lost profits that directly result from the cancellation of the contract. Additionally, the canceling party may still make a claim against the other contracting party if there are lost profits as a result of the performance prior to the cancellation.

In *Telemark Construction, Inc. v. Greenberg*,<sup>66</sup> the court held that where a contractor exercised his contractual right to terminate work after the owner breached (by not timely remitting payments), the contractor was due lost expenses, overhead,

<sup>62</sup> See *Beverly Hills Concepts, Inc. v. Schatz and Schatz, Ribicoff & Kotkin*, 717 A.2d 724, 739 (Conn. 1998).

<sup>63</sup> See *id.* (allowing plaintiff to recover future lost profits, projected until the end of the lease defendant breached); but see *Packard's Western Store, Inc. v. State Dept. of Transp. & Dev.*, 618 So. 2d 1166, 1174 (La. 1993) (allowing the plaintiff to recover future lost profits beyond the expiration of the lease after the plaintiff proved, by a preponderance of the evidence, that it "had an option or reasonable expectation that its lease would have been renewed for some reasonable time period").

<sup>64</sup> See *Allied Fire & Safety Equip. Co., Inc. v. Dick Enters., Inc.*, 972 F. Supp. 922, 935 (E.D. Pa. 1997).

<sup>65</sup> See *Holt's Cigar Co. v. 222 Liberty Assocs.*, 591 A.2d 743, 748 (Pa. 1991).

<sup>66</sup> 613 N.Y.S.2d 900 (1994).



profits and damages.<sup>67</sup> However, the contract specifically limited the contractor's recovery to compensation for the work completed prior to termination. Therefore, the contractor was contractually precluded from making a claim for future lost profits (or even profits due for completion of the project beyond the breach) because those damages "were outside the contemplation of the parties."<sup>68</sup>

Frequently a contract will also list causes for termination (e.g., defective work). In this situation, when an event occurs that justifies termination, under the standards set forth in the contract, the terminated party has no right to anticipated profits.<sup>69</sup>

### [B] Specific/Consequential Damages

Special or consequential damages are damages that have occurred as a result of one party breaching the contract, but were not specifically contemplated at the formation of the contract. They are, in essence, collateral to the contract. These damages must still be reasonably foreseeable, but the fact that they are not referenced in the contract document is not a bar to recovery.

#### [1] Indirect Losses

A common form of special damages are indirect losses, or losses outside the contract that occurred as a consequence of actions by the defendant under the contract. An example is where a contractor is forced to divert work from another project in order to repair the damage done by the defendant's breach. The primary obstacle to recovery of these damages is the issue of "reasonable foreseeability." The plaintiff must show that the defendant could have reasonably foreseen that the plaintiff would suffer indirect losses, due to the actions of the defendant.

In *Downey, Inc. v. Bradley Center Corp.*,<sup>70</sup> a Wisconsin court held that "consequential damages in [the] form of lost profits from projects [the subcontractor] was performing contemporaneously to [its project with the defendant] were not too remote to be foreseeable, and recoverable."<sup>71</sup> In an effort to complete his contracted work, and in the face of several delays caused by the defendant general contractor, the plaintiff subcontractor had to divert both manpower and equipment from other projects it was performing at the same time. The court held that this diversion of work (and subsequent lost profits on the other projects) was foreseeable, and thus could be the basis of recovery. This was due, in part, to the volumes of evidence that the plaintiff produced. Plaintiff's evidence included a memorandum to the defendant stating that Downey pulled workers and resources off other

<sup>67</sup> See *id.* at 902.

<sup>68</sup> *Id.*

<sup>69</sup> See *J.B. Talley & Co., Inc. v. Vilaret Constr. Servs., Inc.*, 722 So. 2d 9, 13 (La. 1999).

<sup>70</sup> 524 N.W.2d 915 (Wisc. 1995).

<sup>71</sup> *Id.* at 915.

independent contracts "to comply with the completion date,"<sup>72</sup> and proof that the defendant did not object when it was "informed that the only way to meet the completion date was to pull resources off other independent projects."<sup>73</sup> Additionally, the plaintiff informed the defendant "that it would send an additional bill for the 'impact' the Bradley Center performance had on its other contracts"; again, without objection from the defendant.<sup>74</sup>

#### [2] Future Lost Work

Another class of special damages sought by plaintiffs involve claims for "future profits" lost as a result of the defendant's actions. The courts generally view these claims with a high degree of skepticism because of the inherent unforeseeability and general uncertainty involved in these allegations.<sup>75</sup>

However, the issue is ultimately a question of fact, requiring the plaintiff to prove with reasonable certainty that future work was available and lost as a result of the defendant's action. For example, in *Independent Mechanical Contractors, Inc. v. Gordon T. Burke & Sons, Inc.*,<sup>76</sup> a subcontractor sued the general contractor for future lost profits, loss of reputation, and other economic hardships suffered after the defendant breached its contractual duty of supervision. The New Hampshire Supreme Court considered whether or not these profits could be proven, to a reasonable certainty, for a period up to three years after the breach occurred. The court held there was sufficient evidence provided to the trial court to substantiate a finding that the plaintiff suffered lost profits at the hands of the defendant for a period of three years after the breach. In doing so, the court stated that "the essential issue is whether the evidence on lost profits provides enough information under the circumstances to permit the fact finder to reach a reasonably certain determination of the amount of gains prevented."<sup>77</sup>

Not all courts have been so open to claims for future lost profits. In *Kenford Co., Inc. v. County of Erie*,<sup>78</sup> the New York Court of Appeals held that where the plaintiff signed a preliminary agreement with the defendant requiring the defendant to negotiate in good faith with the plaintiff for the development of plaintiff's land, and the defendant breached that agreement, the plaintiff could not recover future lost profits. The court reasoned that the damages were not only unforeseeable because the plaintiff's claim for damages extended over a 20-year period that was not shown to be in the contemplation of the parties, but additionally, the damages

<sup>72</sup> *Id.* at 921.

<sup>73</sup> *Id.*

<sup>74</sup> *Id.*

<sup>75</sup> See *Frenz Enters., Inc. v. Port Everglades*, 746 So. 2d 498, 504 (Fla. 1999) (dismissing the plaintiff's claim based on a determination that a claim for lost profits due to a loss of bonding capacity after contracting with the defendant was not foreseeable).

<sup>76</sup> 635 A.2d 487 (N.H. 1993).

<sup>77</sup> *Id.* at 491-92.

<sup>78</sup> 493 N.E.2d 257 (N.Y. 1986).



were too speculative and could not be proven with reasonable certainty. The court held that there were too many conjectures and uncertainties to substantiate a claim for future lost profits.<sup>79</sup>

### [3] Rules for Federal Contracts

In federal contracts, consequential damages are generally held to be unforeseeable as a matter of law.<sup>80</sup> In *Wells Fargo Bank, N.A. v. United States*,<sup>81</sup> the plaintiff claimed lost profits due to the government's refusal to issue a loan guarantee. The court held that this allegation was collateral to the contract and refused to award any lost profits on this issue. In doing so the court stated:

[i]f the profits are such as would have accrued and grown out of the contract itself, as the direct and immediate results of its fulfillment, then they would form a just and proper item of damages, to be recovered . . . upon a breach of the agreement . . . . But if they are such as would have been realized by the party from other independent and collateral undertakings, although entered into in consequence and on the faith of the principal contract, then they are too uncertain and remote to be taken into consideration as a part of the damages occasioned by the breach of the contract in suit.<sup>82</sup>

### [C] Privity of Contract

Generally, the parties to a claim for contract damages must be in direct contract with each other. A typical claim by the owner alleges lost profits due to unnecessary delays by the contractor. In contrast, a contractor's typical claim will be based on actions of the owner that impair the contractor's ability to complete the work in a timely manner, or even to perform on separate projects.

#### [1] Owner's Claims

The typical lost profits claim against a contractor involves delay. When a construction project fails to reach substantial completion<sup>83</sup> by the date set forth in

<sup>79</sup> See *id.*; see also *Goodstein Constr. Corp. v. City of New York*, 604 N.E.2d 1356, 1361-62 (N.Y. 1992); *Frenz Enters., Inc. v. Port Everglades*, 746 So. 2d 498, 504 (Fla. 1999).

<sup>80</sup> See *Olin Jones Sand Co. v. United States*, 225 Ct. Cl. 741, 743-44 (1980) (refusing to award damages to plaintiff where, as a result of the government's actions, the plaintiff lost its bonding capacity and was not able to obtain future work); *Rocky Mountain Constr. Co. v. United States*, 218 Ct. Cl. 665, 666 (1978) (rejection of claim that had the government not delayed contract performance, the plaintiff would have profited on other contracts on which it would have bid); *Northern Helix Co. v. United States*, 207 Ct. Cl. 862 (1975) ("remote and consequential damages are not recoverable in a common-law suit for breach of contract . . . especially . . . in suits against the United States . . .").

<sup>81</sup> 88 F.3d 1012 (Fed. Cir. 1996).

<sup>82</sup> See *id.* at 1022 (quoting *Ramsey v. United States*, 101 F. Supp. 353, 357-58 (Ct. Cl. 1951) (quoting *Myerle v. United States*, 33 Ct. Cl. 1, 26 (1897))).

<sup>83</sup> See *Moduform, Inc. v. Harry H. Verkler Contractor, Inc.*, 681 N.E.2d 243, 248 (1997) (defining substantial completion as the date when the construction of a structure is sufficiently completed, in

the contract (as adjusted for any approved extensions to the project) the owner may assert a claim for lost profits. This claim is based on the delay in the owner's ability to realize the profits the project was intended to produce upon completion.

The owner's claim is dependent on several factors, and the owner has the burden of proof. However courts have been very open to granting lost profits based on contractor delay.

For example, in *Guy T. Williams Reality, Inc. v. Shamrock Construction Co.*,<sup>84</sup> the owner of a rental property filed suit against a contractor for defective construction. The court set forth the requirement that "[i]n an action for breach of contract, the plaintiff may recover damages for proven losses"; and that "[t]he loss of profits must be proven with reasonable certainty and cannot be based upon conjecture and speculation."<sup>85</sup> The owner presented testimony that he planned to use the building as a commercial office building, and "[t]o prove his lost profits (rents) [he] presented the testimony of . . . an expert in the field of commercial property management."<sup>86</sup> Accordingly, the court held that "the plaintiff proved, with reasonable certainty, that it sustained lost profits in the form of rents from the building." and awarded the owner damages in that amount.<sup>87</sup>

#### [2] Contractor's Claims

A less traditional claim for lost profits pits the contractor or sub-contractor against the owner as a defendant. Here, the plaintiff contractor or sub-contractor<sup>88</sup> is typically alleging that the owner's actions have caused the loss of potential profits on the project in question, or even on other projects.

In *Corcoran v. Sanner*,<sup>89</sup> the court upheld a contractor's counterclaim for lost profits. The owner had breached the contract when the contractor was improperly dismissed and another contractor was hired to complete the project. The court held that the contractor's lost profits were based on "the sum which will put the damaged party in the position it would have occupied if the contract had been performed."<sup>90</sup> Another court defined a contractor's lost profits as "the contract price for full

accordance with the plans and specifications, as modified by any complete change orders agreed to by the parties, so that it can be occupied for the use for which it was intended).

<sup>84</sup> 564 So. 2d 689 (La. 1990)

<sup>85</sup> *Id.* at 695; see also *F & F Transfer, Inc. v. Tardo*, 425 So. 2d 874 (La. 1983); *Moss v. Guarisco*, 459 So. 2d 1 (La. 1984), *writ denied*, 462 So. 2d 1247 (La. 1985).

<sup>86</sup> *Guy T. Williams Reality, Inc. v. Shamrock Constr. Co.*, 564 So. 2d at 695.

<sup>87</sup> *Id.*

<sup>88</sup> It is important to determine if the plaintiff is in privity with the defendant. Often the owner will sign a contract with a contractor and several of the larger sub-contractors. However, if the only contract with the owner is between the general contractor and the owner, a sub-contractor may have to file a claim directly against the general contractor or use a remedy other than contract law.

<sup>89</sup> 854 P.2d 1376 (Colo. 1993)

<sup>90</sup> See *id.* at 1380; see also *Flanders Elec. Motor Serv., Inc. v. Davall Controls & Eng'g*, 831 P.2d 492 (Colo. 1992).



Track Procedures (now appearing before the fast track procedures), and the Fast Track Procedures.

### [3] LCIA Arbitration

The LCIA is based in London. It provides a comprehensive international dispute resolution service, both under its own Rules and under the UNCITRAL Rules, for operation under any system of law in any venue throughout the world. The LCIA consists of a President, four Vice-Presidents and up to 25 other members, being leading international arbitrators from the major trading countries of the world. The LCIA, assisted by its Secretariat, oversees the arbitration process. Its role includes the following functions: (1) designation of arbitrators in the absence of agreement of the parties; (2) the confirmation of party-appointed arbitrators; and (3) deciding upon challenges to the arbitrators. Unlike the ICC Court, the LCIA maintains a list of arbitrators.

There are a number of structural differences between the conduct of an arbitration under the ICC Rules and the conduct of an arbitration under the LCIA Rules. Two of the distinctive features of the LCIA Rules, in addition to their flexibility, are discussed below.

#### [a] No Scrutiny of the Award

Under the LCIA Rules, there is no scrutiny process similar to that contemplated by the ICC Rules. However, under the LCIA Rules, after the issue of the award the parties have 30 days in which to ask the arbitrators to correct awards or make additional award regarding claims presented in the arbitral proceeding but not dealt with in the award (Article 27).

#### [b] Costs

According to the LCIA, it attempts to ensure that the costs of an arbitration do not become unreasonable through the following mechanisms:

- the use of tight procedural timetables;
- a fixed scale for arbitrators' fees, with a realistic upper limit, so that such fees do not exceed a reasonable level; and
- its own fees are based on time spent, on the basis of an hourly charge for the Secretariat, plus a modest percentage applied to the fees of the tribunal.<sup>10</sup>

The Schedule of Fees and Costs to the LCIA Rules provides that the fees of the arbitrators range from GBP 800 to GBP 2,000 per normal working day and GBP

<sup>10</sup> LCIA Introductory Brochure, see the LCIA's Web site mentioned above.

100 to GBP 250 per hour for periods less than or in addition to a normal working day. In exceptional circumstances, the fees may be higher or lower.

### [4] ICSID Arbitration

ICSID was created under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States that came into force on October 14, 1966 (the Convention).

148 countries have ratified the Convention.<sup>11</sup> According to ICSID, the reason for its creation "was the belief that an institution specially designed to facilitate the settlement of investment disputes between governments and foreign investors could help to promote increased flows of international investment."<sup>12</sup>

ICSID is an autonomous international organization having its headquarters in Washington with close links to the World Bank. ICSID has an Administrative Council, chaired by the World Bank's President and consists of one representative of each state that has ratified the Convention, and a Secretariat.

ICSID provides services for, *inter alia*, acting as appointing authority of arbitrators for ad hoc arbitration proceedings, conciliation and arbitration of disputes between member countries and investors who qualify as nationals of other member countries.

Relatively few ICSID arbitrations have actually taken place: 72 cases have been submitted to ICSID—3 ICSID Convention conciliation cases, 62 ICSID Convention arbitration cases, and 7 ICSID—Additional Facility arbitration cases. However, a rather substantial number of contracts do refer to ICSID arbitration.

It is worth noting that in order for ICSID to have jurisdiction, a state must give its consent. Consent to ICSID arbitration requires (1) accession to the Convention by the country, and (2) consent by the country in an investment contract or through implementing legislation (advance consent).<sup>13</sup> Provisions for ICSID arbitration are commonly found in investment contracts between governments of member countries and foreign investors of other member countries. Advance consent by governments to submit to ICSID arbitration can be found in numerous bilateral investment treaties ("BITs") which have now been signed.

Mr. Antonio R. Parra, Deputy Secretary General of ICSID, highlights the following "In the 1990s, there was a veritable explosion in the number of BITs. Our estimate, perhaps unduly conservative, is that some 960 BITs were signed from the beginning of 1990 through the end of 1998. The Secretariat of the U.N. Conference on Trade and Development counts over 1,300 BITs for the same period."<sup>14</sup>

<sup>11</sup> "http://www.worldbank.org/icsid" as at September 8, 2000.

<sup>12</sup> ICSID General presentation available on its Web site <http://www.worldbank.org/icsid>.

<sup>13</sup> Tradex Hellas SA v Republic of Albania (jurisdiction), (1999) 14 ICSID Rev — RLJ 161 at 187.

<sup>14</sup> Mr. Parra's remarks presented in a panel discussion at the 94th Annual Meeting of the American Society of International Law held in Washington, D.C. on April 5-8, 2000 (see the ICSID Web site mentioned above).



There are now over 1500 BITs.<sup>15</sup>

Arbitration under the auspices of ICSID is similarly one of the main mechanisms for the settlement of investment disputes under four multilateral trade and investment treaties: NAFTA, the Energy Charter Treaty, the Cartagena Free Trade Agreement and the Colonia Investment Protocol of Mercosur.<sup>16</sup>

Due to their self-contained and exclusive nature, the ICSID arbitration rules differ significantly from those of other institutions: they are not subject to the domestic law of any contracting state, and are more elaborate, providing for the types of recourse against the award usually defined only in domestic arbitration. Indeed, the ICSID Arbitration Rules provides for the possibility, for a disgruntled party to challenge the award. The possible grounds for a challenge include the following: (1) if the arbitral tribunal was not properly constituted; (2) if the arbitral tribunal has manifestly exceeded its powers; (3) if there has been a serious departure from a fundamental rule of procedure; and (4) if the award has failed to state the reasons on which it is based (Rule 51).

In other words, the important feature of ICSID arbitration is that, under the Convention, the courts of a contracting state are powerless to overturn, annul, or refuse enforcement of an ICSID award, even on the ground that it violates public policy. By adhering to the Convention, all contracting states, whether or not parties to the dispute, are required to recognise and enforce ICSID awards as if it were a final judgement of its own court (Rule 54.1), i.e., objection to enforcement may only concern the *execution* as a process of internal law. The Convention also offers post-award remedies, such as rectification, interpretation, revision and annulment of awards (Rules 51-52).

### [B] Ad Hoc Arbitration

The term *ad hoc arbitration* is used to designate an arbitration conducted without reference to a specific arbitral institution which supervises the arbitral proceedings. If both parties are committed to the prompt resolution of the dispute, ad hoc arbitration may work well.

Assuming that ad hoc arbitration is desired in the context of an international construction contract, the draftsmen of the contract should generally be discouraged from attempting to prepare comprehensive rules of arbitration. The authors suggest that, in most instances, such an attempt would be problematic and possibly dangerous. On the contrary, it is advisable that draftsmen simply refer to the Arbitration Rules of the United Nations Commission on International Trade Law, General Assembly Resolution 31/98 (the UNCITRAL Rules), which were designed for such purpose (the UNCITRAL Rules have quickly become the world's leading set of ad hoc arbitration rules).

<sup>15</sup> UNCTAD, World Investment Report (DOC UNCTAD/WIR/1998 (Overview))12.

<sup>16</sup> *Id.*

If the UNCITRAL Rules are used, the question then arises as to who will constitute the appointing authority. The ICC, AAA, and the LCIA are all willing to act as such authority in connection with an ad hoc arbitration using the UNCITRAL Rules.

The primary drawback to ad hoc arbitration is that if one party to the arbitration is attempting to delay or sabotage the proceeding, there is no institution to step in. In such a case, almost inevitably, recourse will have to be made to the courts. The authors do not recommend the use of ad hoc arbitration clauses, which often give the defendant grounds for delay.

### § 15.04 DRAFTING THE ARBITRATION AGREEMENT

Although international construction contracts are almost invariably bespoke contracts, they will usually be drafted on the basis of standard forms, either standard form construction contracts prepared by industry associations like the FIDIC forms or standard form contracts developed by companies or law firms for use on projects, e.g. the standard form EPC contracts developed by most of the law firms with significant project finance practices.

Many international construction contracts (see, for example, Clause 20 of the *FIDIC Silver Book*) contemplate a three-step dispute resolution process. The first step is the obligation to first attempt to amicably resolve the dispute. Often, the parties will be subject to an obligation to involve top management in the attempt at amicable settlement. The second step is some form of alternative dispute resolution such as the use of a dispute adjudication board (DAB) or a dispute resolution board (DRB). The third step is arbitration. A discussion of the use of a DAB or DRB is beyond the scope of this chapter and, consequently, the discussion below will focus exclusively on the agreement to arbitrate.

If the parties to an international construction contract wish to submit any disputes to arbitration, it is essential that they include an express agreement to arbitrate.

There are two indispensable elements of a workable international arbitration clause. The first is an unambiguous reference to the system of arbitration that has been chosen. The second is a clear definition of the scope of the disputes to be arbitrated.

As discussed above, in the absence of special factors, institutional arbitration should be favored, with the choice of a particular institution depending on a number of circumstances, including the nationalities of the parties, the nature of the transaction, the choice of applicable law, the place of arbitration, likely problems of enforceability, and special regional or other factors. Non-specialists are often warned not to tinker with the model clauses recommended by a particular institution.

In this regard, the Freshfields' *Guide to Arbitration and ADR* (referred to above), recommends either to adopt the institution's own model clause intact, or to use the following general purpose model clause for institutional arbitration:



Any dispute, controversy, or claim arising out of or in connection with this contract, including any question regarding its existence, validity, or termination, shall be finally resolved by arbitration under the Rules of the [name of the institution chosen] in force at [give the date hereof/the date of the request for arbitration], which Rules are deemed to be incorporated by reference into this clause.

The tribunal shall consist of [a sole/three] arbitrator[s].

The place of arbitration shall be [city].

The language of the arbitration shall be [language].

In some instances, the parties to an agreement to arbitrate may wish to provide additional definition regarding the composition of the arbitral tribunal, such as the method of selection of arbitrators, and specific requirements as to the arbitrators' nationalities or professional background/qualifications/expertise.

When drafting an agreement to arbitrate, a number of additional elements should also be considered, including: (1) the capacity of the parties to agree to arbitration, (2) the authority to agree to arbitration, (3) the applicable substantive law, (4) the procedural law, (5) the arbitrability of disputes under the law applicable to the arbitration clause, or if different, of the place of arbitration or the likely place of enforcement.

## § 15.05 INTERNATIONAL ARBITRATION IN PRACTICE

This section will briefly review the procedures involved in a typical international institutional arbitration conducted under the ICC Rules.

### [A] Commencement of the Arbitration and Constitution of the Tribunal

Arbitration is not to be undertaken lightly. The arbitration process, in addition to being expensive (e.g., the fees of outside counsel and the arbitrators), requires substantial amounts of management time and attention. Arbitration, during the progress of construction, can be rather disruptive and, in certain cases, may even slow the progress of the works. Most international construction arbitrations are commenced upon the completion of the works.

In the experience of at least one of the authors, there is some value in being seen by the arbitral tribunal as the aggrieved party, i.e., commencing the arbitration.

An ICC arbitration is commenced by filing a request for arbitration with the Secretariat of the ICC court. The request should include, *inter alia*, a description of the nature and circumstances of the dispute and a statement of the relief sought. The request should also include the relevant agreements and, in particular, the arbitration agreement (Article 4 of the ICC Rules). In the event of an arbitral tribunal consisting of three members, the request should also include the name of the claimant's party-appointed arbitrator. Much has been written about the art of choosing an arbitrator. For the purpose of this chapter it is sufficient to state that the choice should be made with care and attention and, of course, with expert advice.

Within 30 days from receipt of the request from the Secretariat (or within such additional time as may be granted by the Secretariat), the respondent must file its answer and any counterclaims (Article 5 of the ICC Rules). If applicable, the answer should also include the name of the respondent's nominated arbitrator.

The arbitral tribunal will be composed of either one or three arbitrators. As discussed above, where the parties have not designated the number of arbitrators, the ICC Rules provide that, except where otherwise warranted by the nature or complexity of the dispute, a single arbitrator will be appointed. In the event of a single arbitrator, the arbitrator will be appointed by agreement of the parties or, failing such agreement, by the ICC court. In the event of three arbitrators, the chairman will be appointed either by agreement of the parties, or by the party-appointed arbitrators if so mandated by the parties, or by the ICC Court (Article 8 of the ICC Rules). Special rules are applicable to the appointment of the tribunal in multiple party arbitrations (Article 10 of the ICC Rules).

After the tribunal is constituted and the provisional advance on costs paid, the file will be forwarded to the members of the tribunal, who will then proceed to establish the terms of reference. The role and content of the terms of reference are discussed above.

### [B] Pleadings and Hearings

Along with the terms of reference, the tribunal will establish a provisional timetable for the conduct of the arbitration. The timetable will provide for the exchange of pleadings and the conduct of hearings.

In ICC arbitrations, there is substantial emphasis on written submissions. Often the written submissions will include an original memorial from the claimant, a counter-memorial from the respondent, and two subsequent reply memorials. The parties will usually include witness statements to support arguments in the memorials. The use of party-appointed experts is discussed at length below. The tribunal also has the power to designate its own experts.

As mentioned above, the scope of discovery in the context of an ICC arbitration is, as a general proposition, more limited than the scope of discovery before the courts in, for example, the United States or the United Kingdom. A position frequently expressed by arbitrators of a nationality other than U.S. nationality is that the arbitration should not be turned into "U.S.-style litigation."

If the parties do not object, the tribunal may decide the case solely on the basis of written submissions. However, in most cases, the tribunal will wish to conduct hearings. Opening statements, if any, will be limited. During the hearings, the witnesses from each side will be given an opportunity to be heard and the other side will be given the opportunity to cross-examine each such witness. In most cases, the parties will be given the opportunity to make closing arguments. Although the hearings are usually conducted in a fashion that is relatively informal, the use of visual aids and in particular power point presentations is prevalent. In one ICC



arbitration in which one of the authors acted as counsel, the preparation of a video describing certain key aspects of the case was undertaken.

The ICC Rules provides for the tribunal to declare the proceedings as closed.

### [C] The Award

Subsequent to the exchange of pleadings and oral testimony and arguments, the tribunal should declare the proceedings closed. When this step is achieved, the tribunal should issue its award. The ICC Rules provide that the award within six months from the date of the finalization of the terms of reference. This delay is extendable either on request from the tribunal or by the Court on its own initiative. In the experience of one of the authors, in ICC arbitrations, the delay from commencement to award can typically be two years or longer. The enforcement of an arbitral award has been briefly discussed above.

## § 15.06 THE USE OF EXPERTS

### [A] Matters for the Experts

#### [1] Introduction

In many respects, the techniques used by the expert in an international construction arbitration are no different to those used in other dispute resolution forums. The environment in which these techniques are applied, however, may require special attention, particularly in respect of factors such as:

- the legal framework in which the claim is founded; and
- the nature and extent of records maintained by each of the parties.

In this chapter we deal with issues affecting the work of both the programming and damages experts in an international arbitration. The term “programming” is used to cover the work normally associated with that of the scheduling expert, as it is known in the United States, or the planning expert, which is sometimes used elsewhere.

It is not intended to comment within this chapter on all of the issues that the programming and damages experts may face, either because of the differing nature of the arbitration rules or the location of either the project or the arbitration hearing. Rather we have included in this chapter those aspects that may require particular attention during the course of the work by either expert. To begin with, however, we deal with those issues that are common to both types of expert or, indeed, to any expert giving evidence in an international arbitration.

### [2] Factors That Influence the Style of the Report

The international aspect of the work, and the nature of the arbitration, will present the expert with different considerations for the preparation of the report as well as the giving of evidence before the tribunal.

### [3] Language Difficulties

There can be language difficulties that the expert must overcome, both in terms of the native language of each of the tribunal members but also because of their professional background. It is not uncommon for the tribunal to be comprised of the same type of profession, such as lawyers. However, on occasion each member of the tribunal may be from completely different technical disciplines. Care must be taken by the expert in preparing their report, as well as when they appear before the tribunal, to make sure that this aspect is not overlooked. A key point for the expert, as ever, is to know the audience and structure the report accordingly.

Many of the techniques that have proved most successful in international arbitration are no different to those used elsewhere, either before juries in the United States or other courts. In particular, the use of clear and colorful visual aids to present the findings may prove to be the most effective, not least because when well-presented they can help to overcome language difficulties.

### [4] Simplicity Versus Complexity

It is not uncommon to find a construction contract extended and disrupted by a variety of distinct but interwoven factors. These inevitably lead to added complexity in the performance of the contract, the recording of how the contract was in fact performed, precisely when and where extra time or cost was incurred, and the accounting for such cost.

In such circumstances it is invariably difficult, and perhaps impossible, for a claimant to be precise about each element of the claim. In relation to the work carried out by the damages expert, there may be no single right answer as to the question of what are the relevant additional costs. The damages expert may therefore be required to address this issue within the report in order that this matter is suitably explained to the tribunal.

Consequently in preparing a claim there may be little merit in using a methodology designed to achieve absolute accuracy. It would only produce a form of spurious accuracy, but at considerable cost to the claimant in preparation, the respondent in review, and the tribunal in examining the evidence and deliberation. It is more reasonable in these circumstances to endeavor to produce a methodology and analysis that is logical, seeks to take into account the factual evidence, as well as the relevant legal principles on entitlement, and present the results in a way that is as clear and simple as possible without being superficial.