

CONSTRUCTION

AVOIDING THE DOUBLE WHAMMY OF LIQUIDATED DAMAGES AND LOST DELAY CLAIMS

On Sept. 5, 2003, the Coast Guard awarded K-Con Building Services a contract to design and build a prefabricated supply warehouse in St. Petersburg, FL. The contract required that the warehouse be completed by July 26, 2004, and included the standard liquidated damages clause, which set a rate of \$564 for each day of late performance.

Consistent with FAR 11.501, the contracting officer (“CO”) found that the Coast Guard would “incur additional costs if the contractor” did not complete the work by the contract deadline and that it would be impossible to ascertain “[t]he extent or exact amount of damages” resulting from the contractor’s failure to meet the deadline. Given these findings, she determined that it was appropriate to include a liquidated damages clause in the contract.

The CO did not “make a specific written determination concerning the impact that a liquidated damages clause would have on pricing, competition, and contract administration.” She also did not document “any consideration of the importance of the time of delivery or timely performance when determining that a liquidated damages clause was necessary.” Thus, there was no definitive written record that the CO considered all the factors required by FAR 11.501 when including the liquidated damages clause in the contract.

When drafting and executing the contract, the Coast Guard did not have any regulations or “settled policies or procedures” specifying how to determine the amount of liquidated damages. The CO used a methodology apparently handed down to her in 2007, when she began on the Coast Guard contracting staff. The CO calculated the “probable actual damages” that the Coast Guard would incur through the following method:

- Estimated the extra “Travel/Per Diem, Inspection & Miscellaneous Costs” that the Coast Guard would incur on a monthly basis upon a delayed completion of the project, including “travel costs for the project manager and a member of the contracting staff, costs for the time of a construction inspector, and miscellaneous costs such as telephone and mail costs.”
- Estimated the annual “Administrative Costs for Government Representatives,” which consisted of “the extra time that would be spent on the project by the Coast Guard personnel involved in the contract’s administration and performance, as measured by the hourly rates for their services.”
- Divided the annual Administrative costs by 12 to establish the monthly cost.
- Divided the sum of the monthly costs for the two categories by 30 to calculate a daily liquidated damages rate of \$564.



K-Con did not contest either the inclusion of the liquidated damages clause, or the rate, prior to the award of the contract.

From the get-go, contract performance was plagued by delays. The contract prohibited K-Con from “commencing work” until a post-award kickoff meeting occurred, but the post-award kickoff meeting did not occur until Nov. 4, 2003 — almost two months after contract award. Beyond that, K-Con experienced delays in submitting the 50 percent design, delays due to extra-contractual work that K-Con had agreed to perform at no-cost, and delays in pouring a concrete slab due to a concrete shortage affecting much of central Florida. Then Hurricanes Charley, Frances, Ivan, and Jeanne came.

Although K-Con did not request or receive an extension of the performance period for other delays, it requested and received an extension for the hurricanes. On Aug. 18, 2004, the parties executed a modification extending contract completion time by 15 days due to Hurricane Charley and on, Sept. 21, 2004, the parties executed a second hurricane-related modification extending contract completion time by 16 days due to Hurricanes Frances and Ivan.

Each modification contained a release absolving the Coast Guard from any further liability attributable to the three hurricanes:

“In consideration of the modification agreed to herein as complete and equitable adjustment for the contractor’s proposal for adjustment, the contractor hereby releases the Government from any and all liability under the contract for further equitable adjustments attributable to such facts [or] circumstances giving rise to the proposal for adjustment, including all claims for impacts, delays and disruptions.”

Both parties agreed that the modifications extended contract completion time for the days K-Con lost due to the hurricanes but did not compensate K-Con for the costs of demobilization and re-mobilization it had to perform because of the hurricanes. Recognizing that the Sept. 21, 2004, modification did not cover these additional costs, K-Con’s project manager contacted the CO the next day and tried to rescind it, “indicating that the modification was inadvertently signed and sent without his knowledge.” In response, the CO stated that K-Con could request cancellation of the modification or leave the modification in place and present a claim for the mobilization costs. K-Con apparently left the modification in place but never followed up with a claim for the additional costs.

In total, the parties extended the contract due date to Sept. 2, 2004, to account for excusable delays during performance. The extended due date, however, did not include extra time for all of the delay that K-Con believed was beyond its control.

K-Con did not complete the warehouse until Nov. 18, 2004, and the Coast Guard did not conduct a final inspection and accept beneficial occupancy of the building until Dec. 1, 2004. The Coast Guard assessed liquidated damages by unilaterally amending the contract and reducing the contract price. Overall, the Coast Guard assessed K-Con for 90 days of delay for a grand total of \$50,760 in liquidated damages.

K-Con responded to the liquidated damages assessment by submitting a claim to the CO on July 28, 2005, contending:

“The assessment of liquidated damages is not appropriate because [it] was not the sole cause of any alleged delays, any alleged delays by [it were] concurrent with the delays caused by the government, the government failed to issue extensions to the completion date as a result of changes to the contract by the government, and the liquidated damages are an impermissible penalty.”

The CO denied the claim on the basis that K-Con’s July 28, 2005, letter failed to explain why it was “not responsible for the delay” and that the CO was “not aware of any event or occurrence that would excuse K-Con’s late performance.” K-Con subsequently filed a complaint in the U.S. Court of Federal Claims. The case is noted as K-Con Bldg. Sys., Inc. v. United States, No. 05-981C, 2012 WL 5990374 (Fed. Cl. Nov. 30, 2012).

K-Con claimed that it should not be assessed liquidated damages and should be paid for the costs of its excusable delays. First, K-Con argued that the contract’s liquidated damages provision was unenforceable because the liquidated damages rate was not reasonably related to anticipated damages and therefore, the rate constituted an impermissible penalty. Second, K-Con argued that its late performance was caused by excusable delays and therefore, the monies that the Coast Guard withheld as liquidated damages should be remitted. The Coast Guard responded that the liquidated damages rate was a reasonable estimate of damages — not an unenforceable penalty — and that K-Con was not entitled to remission of the 67 days of liquidated damages.

In support of its argument that the liquidated damages rate was unreasonable, K-Con pointed to the following deficiencies in the calculation of the rate:

- The rate that the CO attributed to “Constructor Inspector Time” was unreasonable because in previous contracts with K-Con for similar buildings the Coast Guard had used different, lower rates.
- The CO had impermissibly included administrative overhead costs. K-Con asserted that costs associated with Coast Guard employee time should not have been included because the Coast Guard employees involved in contract management would have been paid their same salaries whether the contract was performed on time or not.
- Even if an administrative overhead component is permissible, the method that the CO used to determine the administrative overhead rates was flawed. In attacking the CO’s rate calculation method, K-Con pointed out: (1) the CO had relied on a document that expressly stated that the rates in the document should not to be used to calculate liquidated damages; (2) the rates the CO had used were for services provided to non governmental entities and those rates had no applicability to the contract at issue; and (3) the CO did not know how the rates she relied upon had been originally calculated.

The Court rejected K-Con’s arguments, relying on Federal Circuit precedent stating that so long as the liquidated damages rate is reasonable, a court will not review the process used to calculate that rate:

“None of these purported flaws can provide the basis for challenging the liquidated damages rate set forth in the contract. The Federal Circuit has explained that so long as a liquidated damages rate is reasonable, a court should not ‘inquire into the process that the contracting officer followed in arriving at the liquidated damages figure that was put forth in the solicitation and agreed to in the contract.’ DJ Mfg. Corp., 86 F.3d at 1137. It necessarily follows that, to the extent that a particular component of a liquidated damages rate can be challenged, so long as the component amount is reasonable, the court should not examine how that amount was determined. In other words, there is no legal basis for the court to reject [the CO’s] . . . use of particular percentages, reliance on a particular Coast Guard instruction, or use of particular rates from that instruction. And, plaintiff has provided no evidence that the monthly costs assigned by [the CO] . . . -\$583 each

for the Construction Division and Contracting Division chiefs, \$478 for the team leader, \$2,755 for the project manager, and \$957 for the contracting officer — were unreasonable without regard to how those amounts were derived. All that plaintiff has contended is that [the CO] . . . improperly determined these costs. As a matter of law, such a contention is insufficient.”

The court also rejected K-Con’s argument that it was entitled to remission of liquidated damages due to the hurricanes. Here, the court held K-Con to its releases — “[a]s a general rule, the execution by a contractor of a release which is complete on its face reflects the contractor’s unqualified acceptance and agreement with its terms and is binding on both parties.” The Court ultimately denied these claims as well, noting that the liability waivers were unambiguous. The court found that the CO’s post-modification statement that K-Con could assert its already-waived claims did not change the effect of the modification — the ink was already dry:

“[I]f plaintiff believed that the Coast Guard’s offers to extend the contract completion date did not sufficiently compensate it for all of its damages, then it was incumbent on it to ensure that its right to pursue a claim for additional compensation was adequately preserved in the release. As the court explained in C & H Commercial Contractors, Inc., ‘any reservation of a right or a claim for damages from a bilateral contract modification must ordinarily be manifestly and explicitly set forth in the contract modification which incorporates the parties’ settlement.’ 35 Fed. Cl. at 252; see also Inland Empire Builders, Inc. v. United States, 424 F.2d 1370, 1376 (Ct. Cl. 1970) (per curiam) (noting that when a contractor ‘has, but fails to exercise, the right to reserve claims from the operation of . . . a release,’ the contractor may not, ‘absent some vitiating circumstance,’ maintain a suit that was based on the same events that led to the execution of the release). The releases included in the contract modifications did not contain any reservations.”

In addition to rejecting K-Con’s arguments for remission of liquidated damages for the hurricane delays, the court also rejected K-Con’s arguments for remission of liquidated damages for the post-award kick off meeting and extra work K-Con performed. The court concluded that it had no jurisdiction over these claims because K-Con had merely informed the Coast Guard that it was experiencing these delays, but failed to specifically mention these events in its claim letter or otherwise assert that it was seeking time extensions for these delays.

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The K-Con case contains three important lessons for contractors. First, a contractor should challenge the reasonableness of the inclusion or rate of a liquidated damages clause prior to contract execution. Contractors want to avoid seeming litigious and want to establish a good working relationships with their customers as much as possible. These are valid concerns. But contractors who wait to contest unreasonable contract clauses need to consider what they are giving up for the sake of good client relationships. It is extremely difficult to prove that a liquidated damages rate is unreasonable — not to mention that it is more costly to litigate the reasonableness of a liquidated damages rate in court than it is to negotiate it before contract execution. If you cannot live with a liquidated damages clause — speak up. Contractors who do find themselves litigating a liquidated damages rate need to focus on the reasonableness of the rate; simply attacking the method the government used to calculate the liquidated damages rate will get you nowhere.

Second, both during contract performance and when drafting formal claim letters, contractors need to ensure they are preserving their claims. During contract performance, it is not sufficient to tell the government you are experiencing delays. Contractors must both timely notify the government that they are experiencing delays relief in the form of time, money, or both. Contractors should also strive to be specific in their claim letters. General allegations of “excusable delay” or “changes” without specific support may not qualify as a claim.

Finally, contractors should have procedures in place to ensure that contracts and modifications are not inadvertently executed. Set up internal procedures for reviewing and executing contracts and limit the number of employees who have the authority to do so.

As with many contract performance issues, these best practices may be hard to stick to when there are a number of obstacles, such as hurricanes and supply shortages, affecting contract performance. No major contract is going to proceed flawlessly. But by carefully reviewing contracts before signing them and by arming themselves with procedures to ensure claim preservation, contractors can avoid major headaches and empty pockets down the road.

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