CONSTRUCTION LITIGATION: HANDLING DAMAGE ISSUES

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I. *OVERVIEW OF DAMAGE CALCULATIONS*

A. The Construction Process and Claims

A construction project brings together many entities under contract. These entities are jointly obligated to construct a project to specifications, within a time period at a specific price or according to an agreed pricing method. The entities involved include the following:

- Owner (or owner's representative)
- Architect and engineer
- Construction manager
- Contractor
- Subcontractors
- Civil/Electrical/Mechanical

These entities agree to commit their resources to a complex sequence of interdependent events and transactions. Delays or changes in the scheduled sequence will affect the outcome of the project. Changes in the project's scope during its construction, for example, could affect several other contractors, who each may have to revise labor, materials, equipment orders, and re-sequence work.

The effects of delays and changes can alter various parties' ability to perform and earn a profit. The combination of interdependency among parties to a construction project and the dramatic economic impact of disruption makes construction litigation common. This interdependency may also make an analysis of the causation and related damages sometimes quite complex.

B. Components of Claim

A construction claim consists of two major parts: (1) the entitlement section, which usually includes a detailed description of the actions of inactions of the party from whom relief is sought, entitling the claimant to compensation; and (2) the damages section, which sets forth the calculations and support for the compensation claimed.

It is recommended to have your expert perform relatively quick calculations to determine where damages exist and their approximate amounts. This preliminary look can also help to prepare an effective document request list during discovery. Having accurate estimated damage amounts at the complaint stage can sometimes help to settle cases earlier. **Caution**: The experts in these matters will usually be asked by opposing counsel why the final figures are different from preliminary figures.

A damages analysis, rather than coming at the end of the claim process, should proceed concurrently with the entitlement analysis. Construction claims frequently have multiple theories of entitlement that fit the fact situation. When defending a construction claim, performing damage analyses early can result in finding alternative explanations for increased costs by examining the contractor's own cost records. Such alternative theories frequently identify contractor- or subcontractor-caused damages.

II. *TYPES OF DAMAGE CALCULATIONS*

A. Construction litigation generates a variety of different claims that can result in different types of economic damages. The following are examples:

- Extra work
- Compensable Delays
- Escalation Damages
- Acceleration
- Disruption
- Contractor Termination
- Relocation Costs

There is no single type of damage or method of calculation that applies to every construction project. The following are some typical areas of damage calculations:

1. Extra Work

Extra work is performed by the contractor under changes in scope by the owner or owner's representative. In claiming costs for extra work, the contractor must show

a. the scope of the extra work,
b. that there was no previous inclusion of the work within the contract by change order, and
c. proper calculation of the added labor, materials, equipment, other costs and profit.

2. Compensable Delays

Compensable delays occur when another contract party's actions or inactions delay a contractor. The contractor may receive a time extension and damages reimbursement. When excusable delays occur, however, the contractor may receive only a time extension. An excusable delay results from unforeseeable events beyond the owner or contractor's control, fault, or negligence. Unusually severe weather (as compared with reasonably expected weather for the project location during the expected time period) is an example of excusable delay. If a contractor did not receive an appropriate time extension for an excusable delay, the contractor may have incurred damages through *acceleration* attempts to maintain timetables.

Delays that often call for both a time extension and compensation to the contractor include:

- Failure to provide the contractor site access as scheduled
- Delayed or changed design drawings
- Late delivery of owner-supplies equipment or materials
- Untimely field inspections

Documents Used in Pricing the Impact of Delays. A scheduling analysis representing the project is generally prepared using a computer program that plots the sequence and interdependencies of the project's significant activities. This analysis will reveal the activities' most logical sequence. Many contracts, particularly for large projects, require identification of a critical path. Once the parties to a contract agree on a specific path, a party failing to perform within it may be liable for others' damages attributable to such failure.

The Critical Path Method (CPM) concepts were affirmed in *Appeal of Santa Fe Engineers, Inc.,* ASBCA 34, 225, 87-3 B.C.A. (1987) where the Board concluded that "there is a rebuttable presumption of correctness attached to CPMs upon which the parties have previously mutually agreed. In the absence of compelling evidence of actual errors in the CPMs, we will let the parties "live or die" by the CPM schedule applicable to the relevant time frames...under the earlier October CPM, the suspended AHU work was critical and we find that the first eleven days of the suspension entitles the Contractor to an eleven-day extension to the contract completion date. Under the November CPM, the balance of the suspension applied to noncritical work and no time extension is warranted."

Reliance on the Contract. A delay claim relies on careful review of the contact and related documents. One clause frequently found in construction contracts reads that "in no event shall any delay or extension of time be construed as cause or justification for payment of extra compensation to the contractor."

The courts have generally upheld these clauses where they have not been coerced (*Peter Kiewit Sons' Co. v. Iowa So. Utilities Co.*, 355 F. Supp. 376 (S.D. Iowa 1973)). However, in the May 1986 New York Court of Appeals case of *Corinno Civetta Construction Corp. v. The City of New York*, 67 N.Y.2d 297, 493 N.E.2d 905, 502 N.Y.S.2d 681 (1986), the court listed four

situations in which a contractor may recover delay damages and avoid the application of a broadly worded "no damage for delay" clause:

a. Delays caused by the contractee’s bad faith or its willful, malicious, or grossly negligent conduct
b. Uncontemplated delays
c. Delays so unreasonable that they constitute an intentional abandonment of the contract by the contractee
d. Delays resulting from the contractee's breach of fundamental obligation of the contract

When the contractor is entitled to compensable delay damages, the accountant must estimate the related costs. These costs generally arise from extended contract performance, escalation, and acceleration.

Extended contract performance costs usually increase with the passage of time. For example, assume that a delay made it impracticable to remove a tractor and the tractor's compensable delay was 65 days. The contractor would be entitled to 65 days of the rental cost. If the contractor owned the tractor, the contract may suggest how to price the delay. Usually rental value is used to price contractor-owned equipment included in a delay claim. The equipment's purchase price and depreciation is not usually relevant because accounting depreciation does not measure the item's value.

In addition to equipment, many other contractor costs are "time sensitive" and compensable:

- Supervisory costs
- Site security
- Certain site overhead expenses
- Weather protection and weather impact costs

3. Escalation damages

Escalation claims require proof that costs incurred in later periods had higher unit prices than the prices that would have existed had no delay occurred. This proof is often more difficult than it may first appear. Escalation claims frequently include labor cost. A delay claim on a large complex project is often a series of many individual delays, and the labor cost generally comprises multiple crafts (electricians, pipe-fitters, laborers, etc.) with multiple wage levels (apprentice, journeyman, foreman, etc.) within each craft. Computing the incremental labor cost resulting from these multiple delays often requires an approximation.

4. Acceleration

Acceleration results when a contractor revises the contract schedule to complete the remaining activities in less time than planned. The contractor usually reduces the time span by adding manpower and shifts, increasing overtime and revising work sequences. Acceleration costs include:

- Premium portion of overtime and the inefficiencies associated with extended overtime
- Higher wage rates of added shifts
- Vendors' premiums for expedited delivery of materials
- Equipment increases required to support added crews
- Disruptive effects on the work force causing lower productivity
- Extra hours associated with revised work

The contractor's acceleration claim must prove that the owner or owner-representative decided to accelerate. Depending upon the applicable contractual relationships, the owner's representatives for this purpose may include the contracting officer, architect, engineer, or contractor (assuming a subcontractor accelerates). The plaintiff must obtain the applicable correspondence, meeting notes, witness statements, or other notes and records that prove why the project was accelerated.

5. Disruption

Disruption of the contractor's work force by the owner or owner representative resulting in reduced productivity is often compensable to the contractor. Disruptions affect the contractor's work force in many ways:

- Uneven labor force levels, including overtime
- Inefficient work force level
- Inefficient sequence scheduling, stacking of crafts (e.g. forcing electricians and pipefitters to work simultaneously in the same location)
- Excessive drawing changes
- Early, late, or out-of-sequence material and equipment deliveries
- Performance beyond contract specifications or tolerances

6. Relocation costs

a. Can be extremely high in projects in which tenants or residents need to be relocated for any period of time.

b. Heavy involvement of accounting and economic experts to calculate the cost of relocation which could include:

- Moving costs
- Rental costs (e.g. hotel or apartment)
- Utility costs (in the interim property as well as any re-hook up charges at subject property.

- Storage costs
- Transportation costs
- Extra personnel at site to help with relocation
- Special considerations for certain types of people (e.g. elderly residents in health care hospitals)

III. *DIFFERENT METHODS OF CALCULATION*

- Actual cost method
- Estimated cost method
- Total cost method

A. Actual Cost Method

Courts have shown a strong preference for the actual damage method of calculation. In this method, the actual cost records of the contractor are used to calculate the damages. This method is also referred to as the segregated or discrete cost method. If the existence of the claim is known prior to the completion of the job, it may be possible to arrange the contractor's cost accounting system to allow for the immediate identification of damages. Certainly, whenever there is any thought of a construction claim during a project, every effort should be made to facilitate the record keeping of the damages items.

When detailed cost records exist, whether they are segregated for the claim or not, a line-by-line analysis of the cost records must be performed. During the first review of the records, every item with a significant overrun or underrun should be identified and the causes of these overruns and underruns determined. Do not make the mistake of only focusing on overruns. Sometimes underruns can be equally telling. Examining the reasons for underruns can avoid making unjustified claims for large labor overruns, which result from the contractor's performing rather than subcontracting certain items. In that situation, a correspondingly large underrun may exist in the subcontractor category. Additionally, costs should be explored to determine if certain linkages exist. Not understanding the reasons for cost overruns can be fatal to an otherwise valid claim.

How detailed and elaborate the cost accounting records are is a function both of the size of the project and the size of the contractor. However, the greater the detail and the greater the accuracy of the records, the greater the chances of recovery by the contractor on legitimate claims.

To the extent possible, the actual cost method should be used. Providing many different line item calculations rather than a single damage calculation improves the presentation of the claim and also allows for a more detailed analysis of cause and affect.

B. Estimated Cost Method

One approach often used in construction claims is to estimate the amount of the damages. Contractors are often able to estimate damages with some degree of accuracy. Requiring such estimation is not unreasonable because contractors survive economically by being able to estimate the cost of projects with reasonable accuracy. Oftentimes, the estimated approach is a necessity as the contractor/sub-contractor's accounting records are incomplete or unreliable.

Under the estimated cost method, the claimant furnishes a wide variety of data, including estimates by contractor personnel, expert witnesses, cost data, and accounting records, in an attempt to provide a reasonable value for the damage. It is important that the assumptions used to estimate the damages be carefully examined. Frequently, slight variations in assumptions can produce significant variations in the outcome. When using estimates, the assumptions are critical and must be carefully examined. It is frequently useful to calculate damages under different scenario to vary the assumptions to see the effect on the calculations.

It is also necessary when using this method to be cognizant of other projects performed by the contractor that had similar problems or were similar in design or use so that comparisons can be made. Many contractors maintain histories of their projects that allow cost comparisons. It is important that such histories on prior projects be examined so that the validity of the contractor's estimates can be analyzed accordingly. Most contractors would testify that they base their estimates largely on their prior history on similar types of work. As a result, their cost performance on earlier projects is often relevant and extremely useful in the verifying or attacking the accuracy of the estimate.

C. Total Cost Method

In its purest form, the total cost method computes recoverable damages by subtracting the bid costs (plus profit) from the total actual costs (plus profit). When applying this method to a particular claim, the contractor usually modifies the total costs incurred to account for items such as costs included in change orders and other claim items, costs incurred by the contractor that are not recoverable from the owner and modifications necessary to the bid’s estimated costs.

The use of the total cost method is often discouraged. The total cost method, however, has great appeal to contractors because it allows them to recover what they invariably feel are their damages; all costs expended in excess of the estimate. The courts have often disfavored the total cost method because of the implicit assumption that the contractor did everything right and all cost overruns must be the result of owner actions. In something as complex as a construction project, such a simplistic analysis is subject to attack. The objects of the attack are:

1. The validity and accuracy of the original estimate
2. Errors and deviations from the work plan by the contractor that result in added costs
3. Actions increasing cost (such as weather) that are not the fault of the owner

If the total cost method is used, these points must be addressed by the claimant in any claim presentation as part of its burden of proof.

IV. *DOCUMENT MANAGEMENT AND ORGANIZATION*

A..Construction litigation cases involve numerous documents usually from numerous sources.

B. It is important to employ a database program that documents

1. The type of documents
2. The parties involved - key names
3. The date of the document
4. The date the document was produced and from which party
5. A summary of relevant information from the document

C. A well-planned database can save significant time during the course of the case.

D. Database should be able to be sorted by date, key company name and type of document.

E. Of the thousands of documents that are usually involved, only a few documents are the key documents that need to be easily found.

F. Coordination of experts in respective areas of expertise is crucial because construction cases involve analysis areas that require specialists such as accountants, contractors, engineers, environmental consultants, etc. There tend to be many experts involved in construction litigation cases.

G. The experts' efforts need to be coordinated to avoid duplication and to take advantage of the respective areas of expertise.

1. Assumptions needed in the damage calculation may need to be provided by several different experts.
2. Examples include:

a. The construction expert would provide an opinion of the repairs to be made and the costs associated with the repairs. He/she would also provide an estimate of the amount of time to complete for the relocation analysis.

b. The real estate expert would provide an analysis of the loss of marketability of a new housing project due to the delay in completion of a housing project. This expert would provide the percentage losses due to the delay to the accountant.

c. The accountant would compile the information received from the various experts and summarize the information in simple, easy to understand schedules. The expert uses the time estimates to perform the costs associated with the relocation of residents. The costs to repair could be included in the final summary of damages.

H. Files should be reviewed to assure that information included in one file is not contrary to information relied upon by another expert.

V. *DAMAGE PRESENTATIONS MADE SIMPLE*

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