CONTRACTOR'S OBLIGATION TO MITIGATE DAMAGES

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Abstract
The duty to mitigate damages is recognized as a general principle of law in most jurisdictions and moreover, as a principle of international law[3]*. Therefore, it can be applied by courts in contract claims cases, even when it is not expressly stated by the contract. The main criteria is to determine if the party adopted reasonable measures in order to either minimize its loss or to avoid increasing the other part's loss. The importance of this principle should not be neglected in Construction Contracts, where the Contractor is generally considered as the one obliged to take reasonable steps to reduce costs in the case of an extension of time. Even if the contract breach is attributable to the other party, the courts must consider the Contractor's behavior regarding measures meant to limit the amount damage and the overall negative effects on the economy of the contract. This paper aims to emphasize some aspects regarding the contractual behavior of both Employer and Contractor, when faced with an obligation to mitigate damages in the context of contractual delays, being a useful tool for practitioners for preventing negative financial consequences.*

Keywords: *construction contracts, contractual damages, critical path, extension of time, intermediate deadline.*

JEL Classification: K12, K15

1. Introduction

It is highly important to identify and understand the obligation for mitigation of damages stipulated by the contract and the applicable law. This obligation exceeds efficiently planning the deployment and utilization of resources and can make the difference between the Contractor being granted additional costs or being obliged to pay delay damages. Usually, to divide the responsibility between the Contractor and the Employer or for the diminution of the compensations, the proof of the Contractor's guilt is not necessary. However, the causal link between the Contractor's act or omission and the Employer's non-performance of the obligation is essential.[4]

As a general rule of construction contracts, regardless of its type, FIDIC Conditions of Contract[5], the one imposed by Government Decision no. 1/2018[6] or a hybrid that borrowed some of their characteristics, such as the ones concluded by local authorities, the Contractor should consider taking reasonable steps[7] to reduce costs in the case of an extension of time, even if the delay cause is solely attributable to Employer. The failure to undertake any mitigation measures might interrupt the chain of causation and might affect or reduce the Contractor's claim for supplementary costs and profit.

Ideally, the Employer would initiate an offer in mitigation for the parties to agree upon a scenario which would significantly decrease damages. However, it could be reasonable for the

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[3] The principle is also stated by art. 77 of the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980) and by art, 7.4.8 of the UNIDROIT Principles of International Commercial Contracts (2010 edition); for details regarding art. 77 of the United Nations Conventions on International Sale of Goods, also see J. S. Sutton, *Measuring Damages Under the United Nations Convention on the International Sale of Goods*, http://www.cisg.law.pace.edu/cisg/biblio/sutton.html.
[4] L. Pop, I. Fl. Popa, S. I. Vidu, *Tratat elementar de drept civil. Obligatiile, [Elementary Civil Law Treaty. Obligations]*, Universul juridic, Bucharest, 2012, p. 258.
[5] For a detailed insight on the FIDIC Conditions of Contract, also see International Federation of Consulting Engineers, Ghid de Utilizare a Contractelor FIDIC, [FIDIC Contracts Guide], Asociatia Romana a Inginerilor Consultanti (ARIC), 2014.
[6] Government Decision no. 1/2018 for the approval of general and particular conditions of contract for certain categories of public procurement contracts related to the investment objectives financed by public funds, replaced the former public procurement contracts based upon FIDIC Conditions of Contract.
[7] I. Marboe, *Calculation of Compensation and Damages in International Investment Law*, Oxford University Press, 2nd ed., 2017, pp. 125-126, para. 3.256: "*The principle to mitigate damages implies that the injured party must take reasonable steps to reduce its losses. It depends on the facts of the case which steps are reasonable in a given situation. They may include selling products, stopping the delivery of services, trying to renegotiate contracts, or even giving up unprofitable projects."*

Contractor to reject such an offer.

While the Contractor has the obligation of proving the incurred damages, the Employer must prove that the Contractor failed to make reasonable efforts to mitigate and that mitigation was possible. The last condition is very important because the possibility of mitigation should be analyzed in a reasonable manner and any scenarios where the Contractor would have to go to extreme lengths to potentially minimize damages, should be eliminated. There is a notable difference between the hypothetical measures that the Contractor could have adopted and the reasonable steps he failed to take that could have minimized damages.

But if the Employer who is responsible for a delay event, no matter the cause, does not propose any mitigation options, the Contractor should assess his obligations. If the Contract is silent, the Contractor should analyze applicable law and the general obligations of good faith and cooperation. Regarding the general obligation of good-faith, it is important to bear in mind that contracts must be implemented in good faith, and, therefore, enforce not only what is expressed in them, but everything that clearly arises from the nature of the obligation, or from the law that it falls under.[8]

According to art. 1534 of the Romanian Civil Code: "*the debtor does not owe compensation for the damages that the creditor could have avoided with a minimum of diligence."* From this article we can draw the following conclusions: (i) the creditor has a general legal obligation of action consisting of measures of minimum diligence; (ii) the measures shall be accessible and in the reach of the creditor; (iii) the creditor should consider his own costs, since excessive costs related to exceptional measures cannot be recovered from the Employer; (iv) the adopted measures should be sufficient and taken on time.[9]

2. Delay, poor initial planning & establishing intermediate execution terms

Even if the Employer is responsible for an event causing delay, he can claim that the Contractor had the implicit obligation of continuing the partial execution of works not affected by the delay cause.

As a rule, since the Program of Works is under the control of the Contractor, the Contractor is best suited to manage the risk and minimize any negative effects.

However, if the contract does not provide for intermediate execution deadlines or if the parties do not agree upon such a modification of the contract, the Contractor is entitled to refuse, especially if such actions would cause him excessive costs.

Moreover, the Contractor might want to respect the sequence of works first established in the initial Program of Works, due to technical reasons (e.g. some operations need continuity, some of the works must be executed at the end of the contract in order to avoid deterioration, weather conditions[10] and other restrictions impose so).

3. Concurrent delay causes and the critical path

When facing a request for extension of time and additional costs, the Engineer should carry out a comprehensive review of the facts against the most recent Program of works. By analyzing the critical path prior to the events occurring, the Engineer will be able to determine to whether an event attributable to the Employer negatively impacted the final completion date.

One of the most problematic issues regarding a claim for an extension of time is that of concurrency.

A '*concurrent delay'* was defined as: *'A period of project overrun which is caused by two or*

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[8] Regarding the duty to act in good faith when implementing a contract in different jurisdictions, also see D. Saidov, *Methods of Limiting Damages under the Vienna Convention on Contracts for the International Sale of Goods,* http://www.cisg.law.pace.edu/cisg/biblio/saidov.html (consulted on June 1, 2020), p. 26.

[9] B. Audit, *La vente international de merchandises. Convention de Nations-Unies du 11 avril 1980*, L.G.D.J., Paris, 1990, p.166.

[10] E.g. Normative for the execution of construction and installation works during cold periods of time C16 -1984.

more effective causes of delay which are of equal causative potency.'[11]

Events may either be simultaneously or sequentially, but in ordered to be considered *'concurrent'* they must overlap in their consequences. A notable difference should be made between: (i) the situation when two concurrent events have as direct effect a certain number of days of delay and (ii) the situation when there is a single cause of delay, known to both parties and attributable to only one of the parties, but the other party adapted its execution accordingly.

The second example relies upon the following principle: if one of the parties causes a delay, then it cannot insist upon strict adherence to the time for completion[12] and it cannot claim that any action of the other party that was outside the initial schedule is a concurrent delay.

To obtain an extension of time, the Contractor should prove a causal link between the event attributable to the Employer and the delay to completion. In a similar manner, if an Employer wants to reduce a claim for an extension of time, proof must be brough regarding the link between the Contractor's faulty planning and execution of works and the delay to completion.

Concurrency will often be invoked by the Employer, claiming that the Contractor would not have concluded the works on time anyways, due to his own faulty execution and, consequently, the extension of time should not be granted. Moreover, the Employer might ask for liquidated damages related to the Contractor's delay.

An expert appointed by the court may confirm that the Contractor would, in any event, have been unable to complete by the due date.

However, when faced with this situation a court held that this was irrelevant. Accordingly, the Contractor was not liable to pay liquidated damages even though he would not have achieved timely completion.[13]

If the Contractor is able to prove that the Employer caused the delay, he will prove that he was prevented from completing on time and he will invoke the "*time becomes at large"* theory in order to justify his own contractual behavior.

The Courts will analyze any Employer's claim or notification to the Contractor during the execution period, regarding a delay caused by the Contractor, prior or following the event attributable to the Employer.

Usually, it comes down to a detailed analysis of factual events and a consideration of the critical path to determine if completion was affected by a certain event and by how much.

If both a Contractor and Employer caused delay but following the critical path it shows that the event attributable to the Employer caused the delay, then the Contractor's entitlement to an extension of time will not be reduced.

4. Effective contractual correspondence

An effective contractual correspondence is one of the first and most important aspects in any contractual relationship, especially considering the fact that the Contractor's mitigation obligation begins with promptly notifying the Employer any event that may cause a delay.

For example, in the doctrine interpreting FIDIC Contracts it was stated that the period of 28 days shall begin to run "*not earlier than the reasonable time necessary for the Contractor to determine whether he is entitled to a claim*"[14].

Contractual correspondence may prove that the Employer was aware of the event causing delay before the official notification from the Contractor, especially if he is the one responsable for the event.

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[11] J. Marrin QC, *Concurrent Delay,* Paper presented at the Society of Construction Law, meeting of February 2002, available at https://www.scl.org.uk/papers/concurrent-delay-revisited.
[12] *Trollope & Colls Ltd v North-West Metropolitan Regional Hospital Board*, 1973.
[13] *SMK Cabinets v Hili Modern Electrics Date, The Supreme Court of Victoria*, 1984.
[14] A. V. Jaeger, G, S. Hök, *FIDIC – A Guide for Practitioners*, Ed. Springer, 2010, p. 374.

5. Indirect costs: time-related costs vs. volume-related costs

An extension of time is not automatically linked to financial compensation. Time-related costs are spent for an activity for a given duration. The three most common types of indirect costs include overhead, equipment and labor costs.

According to Order no. 1.826/2003[15], indirect costs should remain relatively constant every month since they are not directly related to and engaged in production.

These costs are, in most cases, related to the necessary period for finalizing all the works and not to the amount of works executed in a certain timeframe.

Indirect Costs are usually pre-determined in the contract as a percentage of the value of the contract, but only refer to the contractual period. However, if the contractual period is extended due to any cause that is not the fault of the Contractor, he will consider himself entitled to recover indirect costs related to the extension. If the same amount of contractual works is executed over a longer period, the Contractor will be entitled to indirect costs for the extension, even if such a provision in not expressly stipulated in the contract.

Computing indirect costs may be difficult since the Contractor might have several ongoing contracts in that timeframe.

6. Formulas for determining indirect costs

There are several established formulas for computing indirect costs in construction contracts, each one having its advantages and disadvantages.

If the parties fail to agree upon the usage of a certain formula, the expert may compute indirect costs by using two or more acknowledged formulas, leaving the court to decide which is the most appropriate.

The Employer may often argue against the application of any formula, since the parties did not agree upon one when concluding the contract and in favor of computing the real costs registered in the Contractor's accounting books. On the other hand, the indirect expenses recorded in the accounting books may be higher, but the Contractor could prefer using a recognized formula instead, to facilitate the process.

Art. 1 of the Romanian Civil Code expressly mentions customary practices among the sources of the civil law. In addition, art. 1272 of the Romanian Civil Code stipulates that a valid contract is binding not only in regard of what is expressly stipulated, but also concerning all the consequences that the established practices between the parties, customary practices, legal provisions or equity give to the contract, according to its nature.

The name of art. 1272 of the Romanian Civil Code (Content of the Contract) is relevant for its interpretation since all obligations imposed by it will be considered contractual obligations.[16]

Since formulas for calculating indirect costs are internationally used on a large scale in construction contracts, they are considered customary practices and they enter the mandatory sphere of contract applicability even if they were not expressly stipulated by the contract.

The Hudson Formula. The Hudson formula is defined as *a formula in which the costs incurred by the Contractor are calculated according to the percentage provided in the offer or contract*.[17] The presumption underlying this formula is that the percentages agreed by the parties for indirect costs and profit for the contractual period should be applied to the actual days of delay recorded.[18]

The Eichleay Formula. The *Eichleay* Formula is one of the most common formula used in construction delay claims whenever the contract involves governmental authorities[19] and there is no

[15] Ministry of Public Finance, published in the Official Gazette no. 23 of January 12th, 2004.
[16] Fl. A Baias (coord.), *Noul Cod civil*, C.H. Beck, Bucharest, 2014, p. 1412.
[17] *Ellis-Don Ltd. v. Parking Authority of Toronto,* 1985.
[18] W. Scwartzkopf, J. J. McNamara, *Calculating Construction Damages*, second edition, Aspen Law & Business, New York, 2011, p. 156.
[19] Idem, p. 127.

concurrent or third-party delay.

Home Office Overhead costs typically include salaries for office staff, insurance costs, office utilities, sales and marketing costs, legal expenses and other indirect costs, which cannot be allocated to a specific project. All these costs have a significant financial impact in the case of contractual delays.

One major limitation of the Eichleay Formula is that it can only be applied when the contract is completely finalized. That means that an interim delay claim raised during the execution of the contract cannot be solved by using the Eichleay Formula.

7. Inaction in determining an extension of time

Late completion of a construction project leads to significant financial consequences. For this reason, when an event causing a delay occurs**,** the Contractor must make his claim within a given time of the event occurring.

In the initial stage, the Contractor will usually not be aware of the magnitude of the event or how the Time for Completion will be affected, but he should make sure that the Engineer and the Employer know about the existence of the event itself as soon as possible.

The Engineer must then respond within a reasonable time. If he gives a delayed response or he waits until completion to see if the time extension is really justified or to assess the final number of extension days, the Contractor might be prejudiced, since he considered that the requested extension will be granted.

The intention of the FIDIC Conditions and usually all construction contracts is that the matter shall be dealt with as quickly as possible so that the Contractor knows if he is entitled to an extension and so that he can then plan the rest of his works accordingly. If the Contractor is of the opinion that the Engineer is unreasonably delaying the assessment, he should insist on receiving a decision regarding the extension of time.

Contractors are often faced with the inaction of engineers or employers asked to determine an extension in a timely manner. Even if a contractor promptly notifies the event causing delay, the following hypothesis are possible: the Engineer may be late to grant the extension of time; the Engineer may fail to grant the extension of time; the Engineer may grant a reduced extension of time after an extremely long and unjustified period of deliberation. Subsequently, Employer might request liquidated damages.

The Contractor will argue that he acted in good faith, having a legitimate expectancy that the extension would be granted and that if the Employer caused the delay he would be unjustly enriched if it were to recover liquidated damages for this period.

Notwithstanding the above, the Contractor should make sure that the Employer is aware of the suspension of works or decrease in rhythm of execution of works during the deliberation time.
Another problematic situation related to the uncertainty of the delay's duration is that the Contractor is expected to be prepared to resume work soon after receiving such an instruction, meaning that he won't mobilize workforce and equipment to another project.

This standby requirement will usually make it impractical for the Contractor to undertake additional work which may have a negative impact on the time-related costs, since all the resources are mobilized for a single project.

In conclusion, if at a certain point it is obvious that the simple failure of the Engineer/Employer of rendering a decision on an extension of time will cause the Contractor not be able to meet deadlines, he should take measures.

8. Measures after a refusal for extension of time

If a Contractor reduced or suspended (in fact) Works while waiting for an extension of time just to find out at a very late moment that the extension was not granted, he might be liable for delay

penalties since at that stage, he will no longer be able to meet the final completion deadline.

In this situation, the best scenario would be for the Parties to agree upon a Variation for acceleration measures.

If the Employer and Engineer are silent regarding this matter, the Contractor could consider unilaterally adopting acceleration measures (employ more resources in order to attempt to complete on time). This could be a safe option for the Contractor to avoid paying liquidated damages.

However, this exceeds the general obligation for mitigation of damages and could be difficult to justify since there was no instruction for acceleration.

The Contractor could bring proof (written contractual correspondence, witnesses), that the behavior of the Engineer/Employer forced him to take constructive acceleration measure since, after an unjustified delay in deciding upon an extension of time, they demanded for an increased rate of progress, in order to meet initial deadlines.

If the court would rule that the acceleration measures were necessary and useful, the Contractor should be reimbursed for all costs related to acceleration measures.

9. Conclusions

Late completion of a construction project leads to significant financial consequences. For this reason, the Contractor has two main obligations: to immediately notify the delay event and to mitigate damages.

Even though the obligation to mitigate damages is an implicit one and should be considered regardless of the facts that it is not stipulated by the contract, courts will have to analyze the reasonable behavior of the parties in the context of the particularities of the Works.

The Contractor is under no obligation to take exceptional measures and bear unreasonable costs that exceed the general obligation of good faith, as long as the parties did not agree upon a Modification of the Contract.

Moreover, if one of the parties causes a delay, then it cannot insist upon strict adherence to the time for completion and it cannot claim that any action of the other party that was outside the initial schedule is a concurrent delay.

Usually, it comes down to a detailed analysis of factual events and a consideration of the critical path to determine if completion was affected by a certain event and by how much.

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