In Milton the Disincentive is Lost: Refocusing on Liquidated Damages in Incentive/Disincentive Contracts

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ABSTRACT

Incentive/disincentive clauses (I/D) are designed to award payments to contractors if they complete work ahead of schedule and to deduct payments if they overrun the completion time. The use of incentive/disincentive clauses in transportation is heavily influenced by §635.127 of Title 23 of the Code of Federal Regulations. The intended effect of this regulation is to facilitate the inclusion of road user costs (RUC) to accelerate projects. However, the unintended consequence is for disincentives to be construed as unenforceable penalties as illustrated in Milton. This article argues for an alternate approach to disincentives where liquidated damages include all reasonable foreseeable damages including RUC. The reasons for this approach are to prevent RUC from being construed as impermissible security for performance, to avoid double counting RUC, and to reflect the asymmetry in the legal principles justifying disincentives as opposed to incentives. In addition to the aforementioned legal issues, State Transportation Departments (STD) often need to consider other issues such as public perception of incentives. This article also discusses some other relevant legal issues such as constructive acceleration/suspension and sovereign immunity. This article is intended for both agency attorneys and contract engineers who work in the area of contract acceleration.
INTRODUCTION

The Code of Federal Regulations defines an incentive/disincentive (I/D) for early completion as “a contract provision which compensates the contractor a certain amount of money for each day identified critical work is completed ahead of schedule and assesses a deduction for each day the contractor overruns the incentive/disincentive time.” The law concerning I/D contracts and contract acceleration is very fluid, since such practices are relatively new and not well-litigated. For example, one case in Tennessee that allowed the modification of an incentive clause, Ray Bell Const. Co. v. State (“Ray Bell I”), was overturned in Ray Bell Const. Co. v. State (“Ray Bell II”) in 2011. The purpose of this article is to alert contract engineers and agency attorneys of some of the issues that have surfaced in court cases concerning I/D contracts. The intent is to make this article accessible to non-attorneys, although important legal language and terms of art will be used for conciseness.

The most important influence behind I/D contracts in transportation is arguably the Code of Federal Regulations and specifically § 635.127 in Title 23, which concerns provisions affecting contract time overruns. The contract procedures described in Title 23, Part 635, including § 635.127, is applicable to all Federal-aid highway projects. Thus these regulations influence significantly the contracting practices of state transportation departments (STD).

The Federal Register discusses the background and motivation behind the authorization of I/D clauses in 1987 in § 630.305, re-designated as § 635.127 in 1997. The regulations enacted in Subpart 635 were intended to improve the assessment of damages for contractor overruns in the following ways. First, the regulations discarded outdated damages rate tables from 1972 that were based on nationwide averages. Second, they instituted a requirement for states to maintain and update their own rate tables. Third, the regulations addressed the use of liquidated damages to include delay-related costs beyond the daily construction engineering (CE) costs. Fourth, they corrected a previous inequity in the computation of the federal pro rata share of liquidated damages. And last, I/D was defined and described. One motivation for authorizing I/D clauses is to facilitate the inclusion of road user costs (RUC) such as delays and safety impacts in critical projects. RUC are damages in addition to construction engineering (CE) costs.

Finch (1989) describes the legal basis for disincentive clauses as the liquidated damage provision from typical construction contracts. The often cited United States v. Bethlehem Steel Co. (205 U.S. at 105) is a paradigm case for illustrating the enforceability of liquidated damages (Tyler, 1994). In terms of construction contracts, Harp (1989) suggests that the vast majority of courts have followed the lead of the Supreme Court decision in Robinson v. United States which held that a liquidated damage clause is not contrary to public policy and is a suitable means of inducing performance, or of providing compensation in the case of failure to perform. If I/D is rooted in liquidated damages, then why stray from the foundation by introducing the concept of disincentives? The section entitled “Discussion of Legal Issues” will present some reasons for discarding disincentives.

Although all fifty states and the federal government have enacted statutes with respect to liquidated damages (Tyler, 1994), the three typical liquidated damages enforceability elements are: 1) damages are uncertain and difficult to prove, 2) parties must have intended for the
liquidated damages in advance, and 3) the stated amount must be a reasonable estimate of the
loss upon breach as in *Rockwood & Co. v. Adams*. The well-known contradiction between the
first and third elements is the requirement for a reasonable estimate which also has to be
uncertain (Harp, 1989). In the majority of jurisdictions, reasonable is interpreted as not being
disproportionate to the probable loss at the time of the contract (*Southern Roofing & Petroleum
Co. v. Aetna Ins. Co.*). However, minority jurisdictions require that there be a reasonable
approximation between the liquidated amount and the **actual loss** and not just probable loss
(Harp, 1989).

In general, construction damages resulting from a contractor’s failure to complete work within a
specified time is the value of the use of the building for the period of delay (*Ryan v. Thurmond*).
Harp (1989) explains that this value includes engineering charges, losses in toll revenues, if
applicable, and cost to the public. The last category includes value of time lost in delay, extra
fuel expended, increases in accident frequency and severity, economic impact of surrounding
areas, and inconvenience to adjacent property owners. The difficulty in establishing the cost to
the public might be one motivation for introducing the concept of I/D.

Heckman (2004) suggests that a symmetric I/D structure has a higher likelihood of enforceability
because an incentive is offered to offset the potential for disincentive damages. Traditionally, the
most significant component of an owner’s delay is actual damages in the form of lost revenues.
For a STD, however, the impact of delays is not in lost revenues but in road user costs (RUCs)
and other societal costs. Thus STD might face difficulties in proving consequential damages
because of foreseeability and reasonable certainty requirements. These issues might be the
reason why current I/D contracting practices incorporate separate liquidated damages and I/D
clauses into the same contract. Most agencies attribute liquidated damages and disincentives to
different types of damages that could result from a breach. According to NCHRP 652, liquidated
damages are typically based solely on the recovery of an agency’s daily construction engineering
costs while incentives and disincentives are based on road user costs (Fick et al., 2010). Another
justification for the collection of RUC is based on the *parens patriae* doctrine which says the
federal government and the states may vindicate the interest of their citizens under appropriate
circumstances (*In re Multidistrict Vehicle Air Pollution*).

On the surface, there is symmetry in incentives and disincentives since they are both designed to
accelerate contract performance (Tyler, 1994). But the legal foundations for incentive and
disincentive clauses are quite different. Thus the promotion of symmetry in I/D clauses could
actually work against enforceability. The concern for incentive clauses is that such clauses might
run afoul of state competitive bidding statutes. Such statutes are designed to prevent favoritism
and fraud, and to ensure uniform and equal bidding. A potential problem in using incentives is
the strategy of bidding low in anticipation of receiving bonus payments to make up for the initial
bid price. Such problems are different from the ones encountered in disincentive clauses.

Incentive and disincentive clauses also differ in terms of practical consequences. It is unlikely
that contractors, who are entitled to a bonus, would challenge its validity; thus potential litigants
are reduced to competitors or taxpayers. Furthermore, incentives do not have to be paired with
disincentives. Harp (1989) argues that courts have not held that the lack of a bonus provision
rendered a liquidated damage provision unenforceable.
Past research has examined I/D contracts in two general ways: case studies and surveys. Examples of case studies include Lewis and Bajari (2011), Strong (2006), MNDOT (2006), Arditi et al. (1997), Lee and Thomas (2007), Let et al. (2006) and FHWA (2004). Most of these case studies were intended to examine the outcome of a particular project or a small subset of projects. None of them examined specifically the issue at hand which is to analyze the legal enforceability of disincentives. Examples of survey-based research on I/D contracts include Strong et al. (2005) and Gillespie (1998). Like the case studies, these investigations were useful for examining the effectiveness of I/D contracts but they did not focus on the legal issue of enforceability.

CASE FACTS AND BACKGROUND

Since most court cases involve multiple issues, the facts from important modern I/D cases are first explained in this section. Then the various legal issues from these cases will be discussed issue by issue in the next section.

Milton Cases

Two companion cases are referred to as Milton II and I (Milton Constr. Co., Inc. v. Alabama Highway Dep’t). Milton II affirmed the rulings on road user costs and a disincentive provision from the Milton I case. Both cases involved a dispute over disincentive payments to the amount of $534,000 that was withheld from the contractor by the highway department. The contract involved the construction of two interstates: I-65 and I-59 in Jefferson County, Alabama. The total cost of the projects was around $7.7 million and $4.4 million respectively. The incentive/disincentive contract specified that the project must be completed and accepted within 330 calendar days for I-65 and 210 calendar days for I-59. For each day of overrun, the contractor was assessed a disincentive payment of $5000 per day for I-65 and $4000 per day for I-59, up to 60 calendar days. The disincentive amounts were in addition to liquidated damages which were $600 per day for I-65 and $450 per day for I-59. Milton exceeded the time for completion by 156 days for I-65 and by 72 days for I-59. This led to the imposition of $93,600 in liquidated damages and $300,000 in disincentives for I-65, and $32,400 in liquidated damages and $240,000 in disincentives for I-59.

One important issue to note is the standard of review that was applied in this decision. The lower court had granted summary judgment in favor of the highway department, meaning the court determined that there was no genuine issue of material fact that could be litigated. Therefore, in its review, the Alabama Supreme Court viewed all inferences in the light most favorable to the contractor, Milton. This case illustrates one end of the spectrum of decisions: decisions that invalidated incentive/disincentive contracts. Not only did the Alabama court overturn the summary judgment from the lower court, it considered the issue over the incentive/disincentive contract as a matter of law and decided it on the merits directly without remanding the case back to the lower court.

Ray Bell Cases
These companion cases involved a dispute over incentive payment for constructing the I-40/I-240 Midtown Interchange in Memphis, Tennessee. The funding was split 90% from the FHWA and 10% from Tennessee Department of Transportation (TDOT). The funding structure was significant because of the FHWA policy to eliminate the use of the pro-rata method for calculating time extensions on quantity overruns. In accordance with this policy, TDOT included a “no excuse bonus” provision that specified that the completion date will not be adjusted for any reason except for catastrophic events. The contract specified that the project shall be completed in its entirety on or before December 15, 2006. The incentive payment of $10,000 per day was capped at a maximum of $2 million, and the disincentive payment, also at $10,000 per day, was uncapped. Ray Bell requested a 289-day extension for all dates but did not accept TDOT’s offer of a 137-day extension of the completion and disincentive dates and no extension of the incentive date. After the completion of the contract, Ray Bell requested a 362-day extension that was again countered by the same 137-day extension offer from TDOT. TDOT determined that the project was substantially completed on December 17, 2006, thus no incentives were paid. Ray Bell claimed it was entitled to $2.5 million in incentives. The Tennessee Supreme Court applied a de novo standard of review meaning there was no presumption of correctness to the lower court’s ruling in favor of Ray Bell.

James Case

James Const. v. State ex rel. Dotd involved a dispute over the disincentive amount that was withheld for the construction of the Louisiana Avenue Interchange on I-10. The contract between James and the Department of Transportation and Development (DOTD) was for the amount of around $19 million and a completion date of June 22, 2003, or a 440 day duration. The disincentive amount was specified as a $10,000 daily road user cost. James was assessed $420,000 for completing the project on August 28, 2003. A de novo review standard was used.

River Road Case

Even though Lyons v. River Road Constr. did not involve an incentive/disincentive contract or road construction, it is included because the holding cited and discussed Milton II. River Road was a dredging subcontractor to Radcliff for a liquid-bulk terminal project with the Alabama State Port Authority. River Road claims additional expenses of around $1.1 million for the unanticipated discovery of rock during dredging. The standard of review of the trial court’s denial of the motion to dismiss was to view River Road’s complaint in the most favorable light.

Bonacorso Case

In Bonacorso Const. Corp. v. Com., the Department of Public Works (DPW) had contracted with Bonacorso Construction (BCC) to rebuild two bridges on I-93 in Reading, Massachusetts. The completion date was November 28, 1987, and a disincentive of $4000 per day was assessed for late completion. DPW and BCC had amended the contract with a new completion date of December 6, 1988, but work was not completed on that date. The contract incorporated DPW’s standard specifications which provided that the contractor shall have no claim for damages of any kind on account of any delay. Though the standard of review was not stated explicitly, the court appears to have made a de novo review.
Good Hope Case

Ex parte Alabama Dept. Of Transp. will be referred by the contractor’s name, Good Hope. Alabama Department of Transportation (ALDOT) had entered into three contracts with Good Hope to undertake various road projects. The contracts specified liquidated damages based on the number of days exceeding the limit, and ALDOT withheld around $600,000 in liquidated damages. Since the action was a writ of mandamus to compel a lower court to dismiss, the standard of review was whether Good Hope may possibly prevail while construing all doubts regarding the sufficiency of the complaint in favor of Good Hope.

Harbert Case

Harbert International (Harbert) was awarded two contracts by the Alabama Department of Transportation (ALDOT) to replace the Cochrane Bridge over the Mobile River (Alabama Dept. of Transp. V. Harbert Intern.). The liquidated damages amount for delayed completion was $4000 total per day for both contracts. The amount assessed was $534,000 for completion beyond the August, 1991, timeframe. Though the standard of review was not stated explicitly, the court appears to have made a de novo review.

Vrana Case

In Charles Vrana & Son Const. Co., Inc. v. State, the Department of Roads in Nebraska (DOR) had contracted with Vrana & Son (Vrana) to reconstruct a road and two bridges. The contract specified a duration of 412 days, a liquidated damages amount of $875 per day and incentive/disincentive clauses. The incentive rate was $4700 per day to a maximum of $9400, and the disincentive rate was $4700 per day with no maximum. The scope of review was for the appellate court to reach a conclusion independent from the lower court. The appellate court found that it did not have jurisdiction to rule on the substance of the case since the lower court only granted a partial summary judgment and not an appealable final order.

Anjo Case

In Dept. of Transp. V. Anjo Const. Co., the Pennsylvania Department of Transportation (PennDOT) contracted with Anjo Construction (Anjo) to rehabilitate the Highland Park Bridge in Pittsburgh, Pennsylvania. This bridge was the second busiest bridge in Pittsburgh. For the floor beam replacements phase, there was an incentive of $43,000 per weekend up to a maximum of six. For bridge closures, there was an incentive of $14,350 per day up to 100 days. Due to omissions and errors by the outside engineering firm, the project was extended by 64 days on June 4, 1987. Thus the completion date was moved to March 18, 1988 but the incentive payment date for opening the bridge to traffic was kept at December 9, 1987. Anjo completed the project by December 9, 1987 and received the full incentive payment. But Anjo claimed it was entitled to more payments due to acceleration among other issues.

DISCUSSION OF LEGAL ISSUES
Enforceability

The first and perhaps the most important issue concerning I/D is the enforceability of such contracts. The comments to the proposed rulemaking to 23 C.F.R. § 630.305 in 1987 foreshadowed the enforceability issues that arose in later court cases. One commentator expressed concern over the separation of the CE and delay-related costs that might “jeopardize the enforceability of the liquidated damages provision.” Courts have recognized the right of freedom of contract and are adverse to holding contracts unenforceable unless they are illegal or they clearly violate the public policy of the state. One such violation of public policy occurs when a contract provision is construed as a penalty. There are several examples where contractors have sought to invalidate disincentive or liquidated damages clauses on such a theory. In *Good Hope* and in *Harbert*, the contractor sought to invalidate the liquidated damages provision as an unlawful penalty. In *Vrana* and in *Milton I*, the disincentive provisions were ruled to be penalties and unenforceable. Furthermore, the issue of enforceability is a matter of law that is decided by the judge. The *Vrana* court granted a partial summary judgment on this basis. The Alabama Supreme Court in *Milton I* invalidated the disincentive clause instead of remanding even though the appeal was of the lower court’s granting of summary judgment in favor of ALDOT. Summary judgment means that there is no genuine issue of fact to be decided by a jury in jury cases.

As explained in *Williston*, the determination for when a clause is treated as a penalty is not a clear line. But courts do look at whether breach damages are reasonably susceptible to be measured by some adequate and approved legal standard. The *Milton I* court discussed the typical criteria for deciding if an amount should be characterized as a penalty. They are: 1) the breach injury must be difficult to accurately estimate ahead of time, 2) the parties must intend for the amount to be for damages and not penalties, and 3) the amount must be a reasonable estimate of damages. The language used in I/D or liquidated damages clauses is not dispositive in construing such clauses as non-penalty. Thus courts will disregard self-serving language and look beyond the label that was applied in the contract clauses to the actions of the parties (Heckman and Edwards, 2004).

Regarding the second criterion, the *Milton I* court held that ALDOT unilaterally decided to include a disincentive clause prior to any negotiations with Milton. This ruling appears to be problematic in light of typical agency contracting and bidding procedures through which contracts are awarded. Perhaps, this would suggest that the use of A+B bidding with I/D contracts might be considered less unilateral, since the bidder submits the cost and time for completion. On Criterion 3, the *Milton I* court stated that ALDOT conceded that it arbitrarily set the dollar amount of the per-day assessment and the maximum time limit for the assessment in the disincentive clause. It is therefore important for agencies to document their basis for disincentive and liquidated damages amounts and time limits. One commentator also recommends the documentation of negotiations with contractors as to the amount of liquidated damages (Heckman and Edwards, 2004), but such negotiations are not typical in public highway construction.
Taking a different approach than the use of I/D clauses, one possible suggestion from this article is to discard disincentives in favor of including all the categories of damages in the liquidated damages clause. Thus liquidated damages would include all potential types of damages including engineering costs, construction costs, administration costs, road user delays and safety impacts. One major reason for this suggestion is the danger of having performance acceleration construed as a penalty. The Milton II court cited Williston to show that a provision included to stimulate performance was unenforceable. The court emphasized contract language that stated it was “in the public’s interest to complete this project at the earliest possible date”, thus the disincentive clause acted as a discouragement or penalty for late completion. The disincentive clause was construed as a security for contract performance via financial punishment and not as compensation for public delays. The Milton II court differentiated disincentives from liquidated damages by saying one was designed to punish a party who breaches while the other was an amount paid in lieu of performance. It is arguable whether project acceleration and damage compensation are that different from each other. In the field of transportation, there is significant research documenting the relationship between work zone duration and traffic impacts for both safety and mobility. From a practical standpoint, an additional day of construction necessarily means that more delay and safety damages result, though the magnitude of impacts varies from location to location. However, the Milton II court seems to say performance acceleration and damage minimization are categorically different. It appears that the court is treating the disincentive phase of a contract as performance and not breach.

Another reason for eliminating disincentives is the potential for liquidated damages and disincentives to overlap. As seen in Milton I and II, any double inclusion of damages in multiple contract clauses could render one clause as redundant and unenforceable. The Milton II court stated that since the liquidated damages clause accounted for delays, there could be no recovery for the road user costs in disincentives. The court described the double recovery as passing “the limit of reasonableness”. The Code of Federal Regulations (23 C.F.R. § 635.127 (c)) states, “The STD may, with FHWA concurrence, include additional amounts as liquidated damages in each contract to cover other anticipated costs of project related delays or inconveniences to the STD or the public … road user delay costs may be include.” The Federal Register explained that FHWA recognizes liquidated damages to include not only CE costs but other project delay-related costs. In § 635.102, the definition for I/D for early completion includes “estimates of such items as traffic safety, traffic maintenance, and road user delay costs.” Thus delay-related costs could be included in both liquidated damages and disincentives, and that double inclusion could make disincentives a subset of liquidated damages.

A third reason for discarding disincentives is that incentives and disincentives are not symmetric in terms of their legal underpinning. Unlike disincentives, incentives cannot be considered a penalty and be ruled unenforceable. But incentive clauses have their own issues in that they might be labeled as gifts or bonuses which might violate public contracting laws. It then appears that incentives and disincentives have different enforceability concerns. This theoretical asymmetry is also supported by empirical data. According to Gao (2010) incentives are applied much more often than disincentives. For example for 32 Kentucky projects, $10,868,395 was paid in incentives while only $21,500 was paid in disincentives for a ratio of 506 to 1. An evaluation of all I/D projects in Missouri from 2008 to 2011 showed approximately $1.7 million was paid in incentives over that period. The average incentives paid was around $84,000 with the
The average incentive days realized were 11 with the median being 7 days. A total of 214 days were saved due to the use of incentives and 72% of the contracted incentives were paid. Seventeen of the twenty projects had incentives paid and the other three completed on time. Thus none of the projects examined involved any disincentives having been assessed. Two possible explanations for the empirical asymmetry are contractors’ desires to maximize earnings and overly conservative completion dates. Unfortunately it is difficult to know the exact reasons as actual acceleration costs and profits are not disclosed by contractors. Despite this fact, the empirical asymmetry supports the notion that the legal basis behind incentives and disincentives are quite different.

The proposed approach is the opposite of CFR’s approach in promoting the use of I/D. CFR explains that I/D provisions are intended for use on those critical projects where traffic impacts should be minimized. By reserving I/D for higher traffic impact projects, there is an emphasis that these kinds of impacts might be unusual and merit closer scrutiny. In contrast, the proposed approach is to let the liquidated damages amount speak for itself. On the higher traffic impact projects, the RUC amounts will naturally be higher. And on projects where traffic demands are under the work-zone or detour route capacities, then the liquidated damages amount will be commensurate with near-zero RUC cost. This approach tries to justify all types of damages directly on the basis of liquidated damages. In contrast, the I/D approach could end up with two related legal hurdles instead of one: to prove that disincentives are liquidated damages and to establish that the liquidated damages are not penalties.

Other I/D Legal Issues

If a court determines that an agency ordered the acceleration of a contract beyond what was specified in the original contract, then the contractor may recover for costs incurred for accelerating project performance. The opposite could also occur, where an agency excuses the contractor for delays. The more unique situation is when an agency expressed no specific commands and yet is held to have constructively ordered the contractor to accelerate. The Anjo court states that such a case could exist when an agency asks a contractor to accelerate or merely expresses concern about the lagging process. In Anjo, the project was delayed because of design and other errors beyond the contractor’s control. The performance date was extended but not the incentive payment date. But instead of treating the tardiness as an excusable delay, the court ruled that there was constructive acceleration so that the contractor should receive the maximum incentive payment. The court reasoned that the contractor accelerated the work to meet project deadlines and not to earn the incentive payment. The support for its decision was that the contractor’s increase in labor costs was greater than the maximum incentive payment. It is surprising that the court made an economic argument based on the difference between the increased actual labor cost and the incentive payment during the time of performance. Despite the problematic economic justification, Anjo cautions against the owner treating the completion and incentive dates as different.

Constructive suspension is a delay order that is inferred from the actions of an agency that causes a delay. In Bonacorso, the contractor asked the court to adopt the principle of constructive suspension to recover damages such as idle equipment, labor rate escalations and home office overhead. The court ruled that the exchanges between the contractor and the agency were
deficient as an order because it did not accurately describe the number of delay days ordered thus
there was no reasonable basis for accurately estimating delay damages.

Though not unique to contract acceleration cases, the role of sovereign immunity has appeared in
many I/D cases. Sovereign immunity means a state and its agencies have absolute immunity
from suit in any court. Some exceptions to this doctrine include actions to compel a state official
to perform his/her duties and declaratory judgments. A requirement in such actions is that the
proper state official in his/her representative capacity must be included as a named defendant.
For example in Milton II\textsuperscript{35}, the court affirmed the validity of suits that named the proper state
office in his/her representative capacity. But in Good Hope\textsuperscript{36}, the case was thrown out because
the agency, ALDOT, was named and not the director of the agency. In both Milton\textsuperscript{37} and
Harbert\textsuperscript{38}, the courts held that the exception to compel a state official to perform his/her duties
was met. The courts explained that once the highway departments had legally contracted under
state law for services and accepted the services, then the obligation to pay was not subject to
sovereign immunity. In Milton\textsuperscript{39}, the court ruled that the disincentive clause was unenforceable
as penalty. In Harbert\textsuperscript{40}, even though the court allowed the suit to go forward, the court
ultimately ruled for the agency holding that the damages against the state are an unconstitutional
divestment of state treasury funds. The contractor had sought un-liquidated damages for the
agency’s failure to consider another scheduling sequence and for extra work performed.

In Good Hope\textsuperscript{41}, the court considered the contractor’s argument that ALDOT could be sued
because of the declaratory judgment exception. The contractor asked the court to invalid the
liquidated-damages clause as an unenforceable penalty. However, the court characterized the
case as nothing more than action for damages. The court explained that the exception applied
only when the action seeks no relief other than the construction of a statute and how it should be
applied in a given situation. Likewise in River Road\textsuperscript{42}, the court distinguished the case from
Milton\textsuperscript{43} and characterized the claim for unanticipated expenses as an action for damages and not
a declaratory action.

In Ray Bell\textsuperscript{44}, the court considered the parol evidence rule which affected the admissibility of
external evidence in interpreting the incentive/disincentive contract. Under this rule, an
ambiguous contract could be interpreted using extrinsic evidence. The court held that the plain
language of the contract, including the incentive/disincentive provisions, was unambiguous thus
the contractor was not entitled to use extrinsic evidence to prove the incentive payment date was
changed contrary to the contract language. Ray Bell\textsuperscript{45} also discussed the Critical Path Method
(CPM) for construction scheduling and its importance in incentive/disincentive contracts. If a
delay were to arise, then CPM will help to determine which tasks were critical and dependent
upon previous tasks.

CONCLUSIONS

“And that must end us, our cure to be no more; sad cure!”
- John Milton, Paradise Lost

In light of the legal issues that have surfaced in Milton I and II\textsuperscript{8} as well as in other I/D cases, the
following agency best practices are suggested. The most significant recommendation is to
discard disincentives in favor of including all damages as liquidated damages including road user costs (RUC). This approach would facilitate disincentive clauses from being construed as mere performance acceleration thus unenforceable as a penalty. This will also avoid specifying overlapping RUC damages in both the liquidated damages and in the disincentive provisions. Furthermore, incentives and disincentives have different enforceability issues. The former could be construed as unenforceable penalties, while the latter as illegal gifts or bonuses. If indeed I/D is rooted in the foundation of liquidated damages, then a deviation in language could forfeit such a bedrock.

The authors are aware that STD need to carefully balance many issues beyond just legal issues. One issue that motivated the historical use of disincentives is the promotion of public understanding and acceptance of incentives. Those who advocate for the symmetry in incentive/disincentives contracts suggest that this symmetry helps to justify the use of incentives to the public. Another issue appears to be the hope that the disincentive language is a greater motivating factor than liquidated damages. The authors also believe that language is powerful and words need to be chosen carefully in contracts. But could not incentives, re-named as liquidated savings, coupled with liquidated damages serve the same purpose as I/D?

It is important for agencies to document their basis for the disincentive and liquidated damages amounts and time limits. This documentation helps an agency to establish that damages are difficult to accurately estimate ahead of time and that the amount specified in liquidated damages is reasonable. The communication of the basis for liquidated damages to contractors could also help to establish that both parties intended for the amount to be damages and not penalties. But self-serving language in the contract might not be dispositive in the enforceability determination.

Agency staff should be careful in what they communicate to contractors concerning project acceleration or suspension even if the acceleration was not written in the original contract. Courts could apply the theory of constructive acceleration and hold that a contractor was entitled to incentive payments even if work was completed beyond the date specified. Thus a court could construe communications as actual orders that modify a contract. Similarly, a court could excuse a contractor from disincentive payments if they found that an agency constructively approved delays.

LIST OF CASES

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Rockwood & Co. v. Adams, 486 F.2d 110 (10th Cir. 1973).

WORKS CITED


ENDNOTES

1. 23 C.F.R. § 635.102 (2012).
2. 23 C.F.R. § 635.127 (2012).
10. 17 Am.Jur.2d Contracts, § 178 (1964)
22. Williston on Contracts, op. cit.
27. 23 C.F.R. § 635.127, op. cit.
29. 23 C.F.R. § 635.102, op. cit.
30. 23 C.F.R. § 630.305, op. cit.
38. Alabama Dept. of Transp. V. Harbert Intern., 990 So.2d 831 (Ala., 2008).
40. Alabama Dept. of Transp. V. Harbert Intern., 990 So.2d 831 (Ala., 2008).
41. Ex parte Alabama Dept. Of Transp., op. cit.
42. Lyons v. River Road Constr., Inc., op. cit.