

## Liquidated damages in infrastructure projects performed in the public procurement regime

### Report summary

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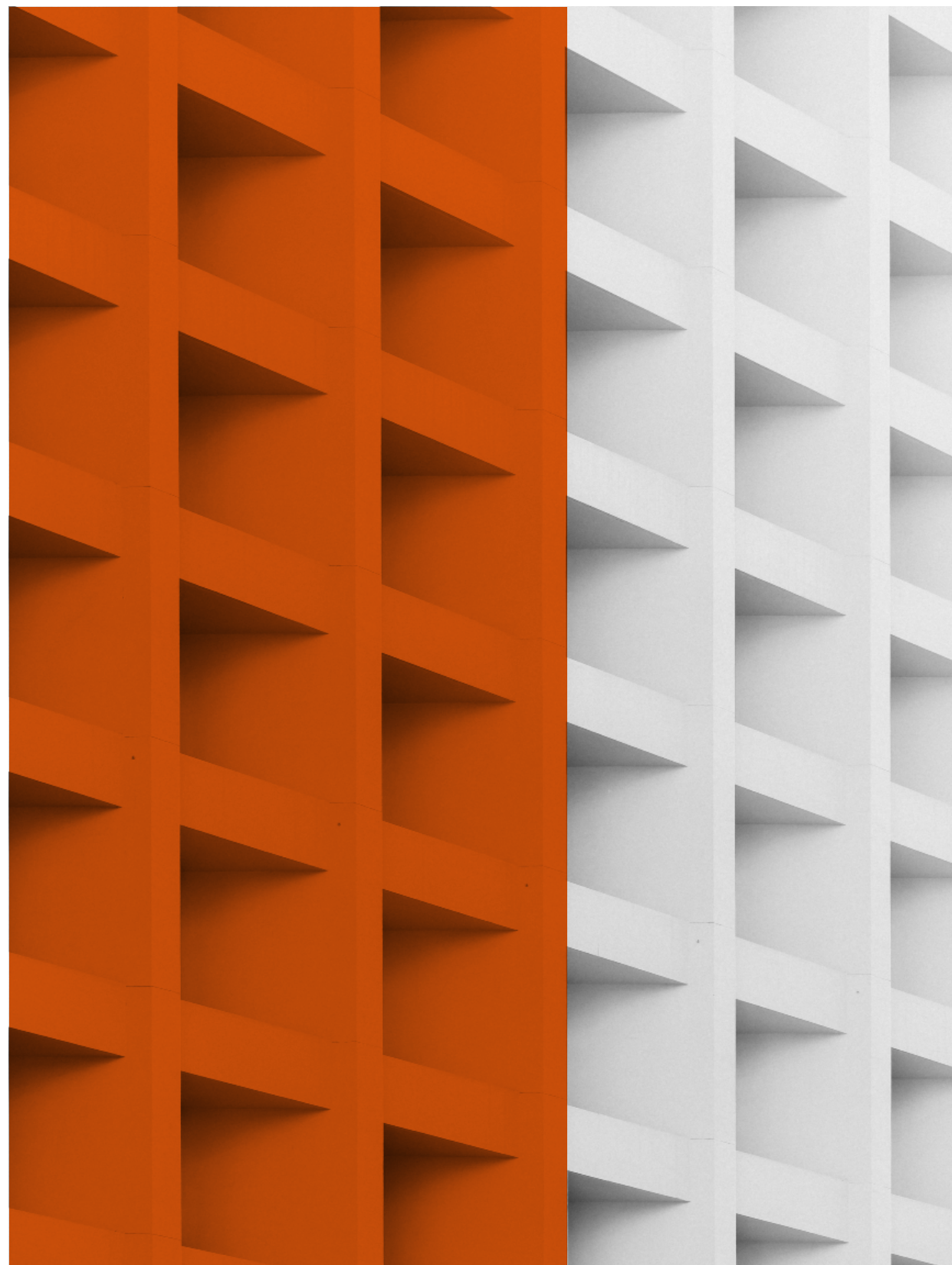
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POLSKI ZWIĄZEK  
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# Introduction



*For more than ten years of our practice we have been observing the growing importance of liquidated damages, in particular when it comes to contracts performed in the public procurement regime. This results, on one hand, from an ever-increasing catalogue of liquidated damages, including liquidated damages provided for directly by public procurement regulations, and the growing legal awareness of contracting authorities that have become more willing to charge contractors with liquidated damages, on the other hand.*

The current practice of public contracting authorities of stipulating and imposing liquidated damages materially affects all contractors from the industrial projects, railway, road, power and gas sectors. In the recent years, entities performing construction contracts have been facing a lot of difficulties caused by i.a. defective tender documentations, dynamic changes in the economic environment or improper performance of contracts by contracting parties, which are often the grounds that contracting authorities use to charge liquidated damages.

Considering the above, we decided to prepare a report with the primary aim of identifying key problems relating to liquidated damages that contractors have been encountering. The report is based on data collected in a survey. Our intention was also to start a wider discussion on liquidated damages under public contracts and potential legislative changes if the report findings show there is such a need.

In this report, we comprehensively analyse practical issues regarding stipulating and enforcing liquidated damages by public contracting authorities. However, for comparative reasons, we also put some aspects into the context of contracts performed for private investors.

This report covers the railway, road, power and gas sectors and industrial projects, however the collected data have been presented globally. This is mainly because we did not identify any significant differences between the individual sectors as to how contracting authorities and contractors approach the issues addressed in the survey.

As the survey subject that we proposed has a practical impact on the entire environment of contractors, it enjoyed great interest of industry organisations, including Chambers of Commerce, that we had invited to collaborate with us.

We complied the report in collaboration with:

- Polish Association of Construction Industry Employers
- Polish Economic Road Association
- Land Transport Chamber
- Chamber of Natural Gas Industry
- Chamber of Power Industry and Environment Protection

whose representatives provided valuable comments that are included in the report.



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## Methodology

*The report was prepared based on dedicated surveys carried out among contractors, suppliers and service providers performing contracts for public contracting authorities from the infrastructure and construction sectors. The surveys were addressed to executives, contract and project directors, heads of legal departments and claim managers. More than 100 respondents representing key sectors, including road, railway, gas and power industries, contributed to the report. The survey participants included representatives of companies performing small (up to PLN 20m), medium (from PLN 20 to 150m) and large (above PLN 150m) contracts.*

The survey covered i.a. the following questions:

- assessment of the impact of liquidated damages stipulated by contracting authorities on contractor's tenders;
- assessment of contractors' ability to shape contractual provisions on liquidated damages during tender procedures;
- symmetry between liquidated damages stipulated with respect to both parties;
- upper limit of liquidated damages;
- amount and adequacy of liquidated damages stipulated for contractors possible breaches;
- possible aggregation of liquidated damages charged to contractors;
- contracting authorities' practices regarding enforcing liquidated damages.

In addition to selecting one of the provided answers, the respondents could also add their own comments, and they often did, sharing they personal experiences and observations. This confirms even further how important and current the addressed issues are.

To compile the report, we also reviewed publicly available information regarding specific cases of stipulating and enforcing liquidated damages by contracting authorities; we did not use pooled data or data previously published by other organisations.

When identifying key problems, we analysed how far the respondents agree as to the importance of a given issue. We additionally assessed the collected data through the prism of our experiences gained within over 15 years of defending contractors against liquidated damages charged in connection with performing contracts in all the sectors listed above.



## Summary

### Conclusions

The survey results lead to the following conclusions:

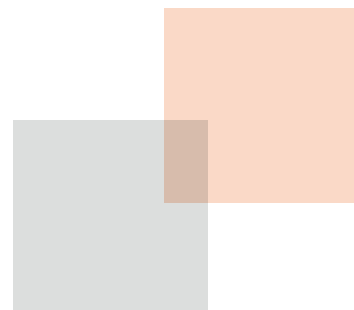
- There is a direct link between the amount of liquidated damages stipulated by contracting authorities and the prices offered by contractors, and consequently the costs that contracting authorities incur to perform a given contract. Nearly 80% of the respondents reported that when calculating tender prices, they take into account the amount of liquidated damages stipulated by a contracting authority and the catalogue of grounds for charging them.
- Contractors, suppliers and service providers negatively assess the current practices of public contracting authorities when it comes to stipulating and enforcing liquidated damages. This assessment was similar in all the sectors (road, railway, gas, power). Nearly 45% of the respondents stated that recently liquidated damages are stipulated and enforced in a way giving a considerable advantage to contracting authorities.
- The amount of stipulated liquidated damages is disproportionate to the actual consequences of contractors' misconduct and the impact of this misconduct on the project. For instance, over 97% of the those surveyed stated that public contracting authorities stipulate liquidated damages for delay in completing works at a certain stage or removing a single defect, however, charge liquidated damages based on the value of the entire contract instead of a respective stage or defect. This makes liquidated damages excessive and disproportionate already at the point of their stipulation.
- Lack of any upper limits for liquidated damages until 1 January 2021 resulted in gravely excessive liquidated damages given the consequences of respective breaches. The enacted amendment to the public procurement law solves this problem only to some extent.
- Lack of symmetry in provisions regarding liquidated damages stipulated towards both parties is clearly noticeable. Nearly 50% of the respondents pointed out to actual contracts under which contracting authorities are not required to pay any liquidated damages, even if they fail to fulfil their main contractual obligations or a contract is terminated due to their fault.
- Negatively assessed is an ever-growing catalogue of liquidated damages stipulated towards contractors and service providers, including imposing liquidated damages that to some extent may overlap. Contracts vaguely and imprecisely describe situations when liquidated damages may be charged, which makes it difficult for contractors to assess the involved risks and defend against being charged with liquidated damages.
- At the stage of a tender procedure, contractors' suggestions and requests aimed at rationalising the amount of liquidated damages or clarifying the provisions governing them are rejected. According to nearly 70% of the persons surveyed, contractors have no or very limited influence on the amount and catalogue of liquidated damages stipulated by contracting authorities.

## Proposed solutions

*In our view, based on the data and conclusions presented in the report, we suggest the following corrective measures.*

First, it would be reasonable to devise a code of good practices concerning liquidated damages in public procurement (with division by industries and sectors). This document should be created through a dialogue between contracting authorities and contractors, taking into account the legitimate interests of both sides, and the efficiency of performing public contracts. An important role in initiating the creation of the said code of good practices could have the President of the Public Procurement Office. His competences include i.a. preparing and disseminating samples of contracts and rules of procedure used in public procurement procedures (art. 469(7) of the Public Procurement Law). An alternative solution could be extending the codes of good practices governing relationships between contracting authorities and contractors that already exist or are under preparation by rules on imposing liquidated damages.

Second, in light of the report findings it is reasonable to clarify the provisions of the amended Public Procurement Law in respect of an obligation to set a limit for liquidated damages. The existing regulation that allows contracting authorities to freely determine this limit should be replaced by a maximum limit of liquidated damages of 20% of the net value of a given contract.



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