

CONTRACTS

Liquidated Damages Clauses

what is a contractor's risk for delays?

By Christopher S. Drewry

Where a contractor has been delayed by an owner (or by a third party for whom the owner is responsible), that contractor may be entitled to recovery in the form of an extension of time or monetary compensation. But what happens where the owner has its project delayed through the fault of the contractor? What can the owner recover and what is the risk to the contractor?

Even if an owner has been delayed through the fault of the contractor, the owner still must be able to establish damages attributable to that delay. For an owner dealing with contractor-caused delays to the work, the proof of actual damages attributable to those delays may be very difficult (particularly if the owner is a public owner who may not typically have "lost profit" or "loss of use" types of damages). As such, an owner's recoverable damages as a result of delays can range anywhere from a minimal amount to a very large sum of money, depending on the impact to the project and what can be established causally.

In terms of contractor risks for delays, they are not yet out of the woods. If the owner

cannot otherwise establish actual damages, the owner still may be able to contractually shift the financial risk of loss to the contractor for the unexcused delays. This contractual mechanism is the liquidated damages clause provided in the contract between the owner and contractor. Such a clause "liquidates" or establishes a specified amount of damages to which the owner will be entitled for unexcused contractor-caused delay past contractual substantial completion. These damages are calculated on a per diem basis for every day that substantial completion of the project is delayed. For example, if a contract contains a \$1,000.00 per day liquidated damages clause, and the contractor is ten days late in finishing the project, then the contractor will be liable to the owner in the amount of \$10,000.00, despite the fact that the actual damages may be otherwise.

NO PENALTY

In most jurisdictions, liquidated damages clauses are generally enforceable, provided that the provision reasonably quantifies the actual damages suffered and does not

appear to penalize the breaching party. Courts are reluctant to rewrite the parties' negotiated terms of a contract, including the liquidated damages clause, and thus will enforce liquidated damages clauses so long as the damages are not considered a penalty. Further, a fixed amount stipulated in a contract typically will be construed as an agreement for liquidated damages rather than a penalty in the absence of evidence tending to show that the amount of damages claimed is unreasonable.

As a general rule of thumb, there are two key aspects which many courts will examine regarding the enforceability of liquidated damages clauses: (1) whether the liquidated damages provision attempts to secure an amount for the non-breaching party which is reasonably proportionate to the amount of actual damages which would be sustained in the event of a breach, and (2) whether the provision for liquidated damages is designed to represent the measure of actual damages, or is it an apparent effort to penalize the breaching party such that the damages will be disproportionate to the actual damages

sustained. In other words, where the actual damages are uncertain or difficult to ascertain or prove, or alternatively where they are of a purely speculative character and the contract furnishes no data for their ascertainment, a liquidated damages provision likely will be upheld, provided the sum contracted to be paid does not appear to be unreasonable in amount.

DOWN TO THE DETAILS

Liquidated damages should be evaluated when making of the contract and may be deemed unreasonable if they are grossly disproportionate to the loss which may result from the breach or unconscionably in excess of the loss sought to be averted. Yet, while reasonableness and proportionality are polestars in an inquiry into whether a liquidated damages provision is enforceable, there often are no hard and fast guidelines, and the determination of enforceability typically turns on the balance of the particular equities of a given case.

If there is a valid liquidated damages clause in the contract, what happens next? At the outset, the presence of such a clause does not preclude the need for a threshold inquiry into the cause of the delay in question. Typically, if the cause of the delay is solely that of the owner, and the contractor has timely and properly given notice of its delay and requested a time extension, then the liquidated damages clause will not be applicable. However, where there is a concurrent delay (in other words, both the owner and the contractor have caused delays), the cases are split on the issue of whether liquidated damages will be imposed. If the owner has contributed to the delay, the majority rule, strictly by weight of authority, seems to be that the liquidated damages clause will not be enforceable against the contractor, even if the delay can be prorated. Nevertheless, the owner may still seek to recover its actual damages for the contractor-caused delays through the allocation of the concurrent delay events.

For the contractor who has a liquidated damages clause in their contract, they should presume its enforceability in determining the risks associated with whether they can

meet the contractual date of substantial completion. The contractor also should administer the project with a keen awareness of this provision and be prepared to document any delay events and provide timely notice to the owner when those events are not contractor-caused. This sets up the best defense to this contractual clause. With no delay causation attributable to the contractor, the per diem assessment of liquidated damages is precluded. ■

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