

Liquidated Damages Clauses

What is a Contractor's Risk for its Delays?

By Christopher S. Drewry

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 a contractor's risks for its delays, if the owner cannot establish actual damages, the contractor is not yet out of the woods because the owner still may be able to contractually shift the financial risk of loss to the contractor for its 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.



From an owner's standpoint, the liquidated damages clause is favored on those projects where it may otherwise have a difficult time calculating its actual losses. Specifically, such a clause may be utilized where time is of the essence and the owner runs the risk of incurring what otherwise may be a difficult loss to quantify. A notable example is the public owner whose new project is delayed but it is not an income-generating facility so as to make it impossible to track loss of revenue or other damages for delayed contract completion as otherwise may be the case in a commercial setting. In an instance such as this the liquidated damages clause will enable that owner to collect the liquidated damages as stipulated in the contract, thereby avoiding the risks and uncertainty in trying to prove its actual damages.

HOW DO COURTS VIEW LIQUIDATED DAMAGES CLAUSES?

The widespread and longstanding rule regarding the enforceability of liquidated damages clauses is that these

clauses are enforceable when (1) the actual damages resulting from the delay could not be readily ascertained at the time the contract was made and (2) the amount assigned as liquidated damages represents a reasonable estimate of the damages that may be sustained and is not considered a penalty. Put another way, liquidated damages must be based upon a reasonable forecast of loss to the owner if the project is not finished by the stipulated date of completion. Thus, the liquidated damages should be a reasonable approximation of the actual anticipated damages from the loss of use of the project.

Based upon these long-established rules, liquidated damages clauses have been held enforceable in a number of jurisdictions.

The liquidated damages clause is a powerful tool against a contractor. If deemed a valid provision, a court may enforce it even in situations where the liquidated damages are greater than the actual damages as well as situations where the actual damages exceed the liquidated damages. Absent

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a clearly expressed clause to the contrary, where there is an enforceable liquidated damages clause, courts will generally hold that an owner cannot recover both liquidated damages and actual damages.

WHAT STRATEGIES CAN THE CONTRACTOR EMPLOY?

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

If there is a valid liquidated damages clause in the contract, what options does the contractor have? 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 owner- and contractor-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.

It is also important to point out that the liquidated damages clause is not a weapon limited only to the owner's arsenal against the contractor. Just as an owner can recover stipulated liquidated damages from

the contractor, so too can a general contractor recover liquidated damages from a subcontractor. And, just as the owner cannot recover its actual delay damages when the liquidated damages are stipulated, so too is a general contractor limited in its recovery from a subcontractor where liquidated damages are stated in the subcontract.

CONCLUSION

Liquidated damages clauses can have a large effect on all parties to a contract, from the owner to the contractor and on down to the subcontractors. Courts have held that liquidated damages clauses are enforceable where the nature of the contract is such that upon breach the resulting damages would be uncertain and difficult to ascertain, without being greatly disproportionate to the actual loss. There can be a fine line with regards to the amount stipulated as liquidated damages. As such, both the owner and the contractor will want to give long and careful consideration to the liquidated damages clause and the risks associated with delays on the project. ■



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