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LEGAL



Liquidated damages: Be sure you get what you bargained for

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At some point in the life of every construction business, a project will not go as planned.

For whatever reason, the project just does not unfold as it was originally designed. Maybe it was because another contractor had to repair its own mistake, maybe it was bad weather, or maybe the work was just slower than what was initially estimated. Despite best efforts, the original schedules become a thing of distant memory.

Anyone who has been in this situation knows that it does not take long before the finger pointing begins, which is quickly followed by damage claims related to the delays.

However, delay damages can be very difficult to quantify and calculate. Some elements may be fairly concrete, such as rents lost due to a building opening 90 days late. Other elements are more neb-

ulous, like the value of the extra time of office employees spent working on the project (extended home office overhead), lost opportunities of other projects, etc.

One solution to some of the uncertainty of delay damages is the inclusion of a liquidated damages clause in the construction contract.

In a nutshell, liquidated damages clauses provide that the non-breaching party is entitled to a certain amount of damages if specified conditions are not met. Probably the most common example is a provision that awards one party a certain dollar figure per day a project is late in completion.

Like so many other provisions, liquidated damages clauses are deal points that are negotiated. If you worked to get a liquidated damage clause included in your contract, you certainly want to be

sure it is enforceable.

To be valid, a liquidated damages clause must satisfy a two-part test.

First, the damages covered by the clause should be incapable or difficult to estimate at the time of the contracting.

Second, the liquidated amount must be a reasonable calculation of expected damages. The key is that a liquidated damages clause must not be a penalty. For example, a provision that provides \$5,000 per day that a project is late, when the actual amount of damages relating to the delay is closer to \$500, is likely to be struck down. The clause does not provide a reasonable substitute for actual damages, but rather, it acts as a penalty.

A liquidated damages clause that is considered a penalty is not enforceable. In other words, that heavy-handed damages clause that you traded some deal points to have included in the contract may be worthless.

These clauses can be particularly powerful when used in combination with a provision that specifically states that liquidated damages are the exclusive remedy available for breach of the contract. This essentially eliminates the possibility of recovering consequential damages. From the owner's perspective, this could create a higher per day amount. From the contractor's perspective, it provides some limitation on potential liability.

In any event, liquidated damages clauses should be as specific as possible to prevent confusion down the road. If damages are to accrue on workdays only,

language to that effect should be included. Conversely, if weekends and holidays are to be included in the damage calculation, that should be explicitly stated. Ambiguity can cost you. Considering the fact that there are around 100 weekend days in a year, not to mention holidays, a 12-month delay could potentially increase (or decrease) damages by almost a third.

Liquidated damages clauses are an effective way to remove some of the uncertainty related to construction delay claims. The specific details are negotiable, but they need to be a reasonable estimate of difficult-to-calculate damages.

Should the dispute go to litigation, these clauses can lower expenses incurred in determining the exact amount of damages related to the delay. However, these clauses may also be the sole remedy should a construction project go bad.

The specifics of each contract will determine whether a liquidated damages provision is appropriate, but it is always a good item to have in your negotiation toolbox.

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