UTCLE The University of Texas School of Law

Presented:
2011 Construction Law

September 22-23, 2011
Dallas, Texas

The Use and Enforceability of Liquidated Damage Clauses

Anthony J. Gonzales
Gerald L. Stovall

Author contact information:
Anthony J. Gonzales
Spire Consulting Group, LLC
Austin, TX 78701-3038
Phone: 512-637-0845
Anthonyg@spirecg.com

Gerald L. Stovall
Hall, Render, Killian, Heath & Lyman, P.C.
Louisville, KY 40202-4267
Phone: 502-568-1890
GStovall@hallrender.com

Table of Contents

I. Introduction

Benjamin Franklin advised that "*Time is Money*". In very few industries do Mr. Franklin's words ring more true than construction.

When a construction project is late in completing, the contractor suffers increased costs related to additional costs for general and special conditions, and the lost opportunity to recover profit and overhead on other projects. If the owner or its representative caused the delay to completion, the contractor may be able to recover these costs and lost profit and overhead.

Construction owners also suffer additional costs when project completion is delayed, such as lost income or profit, loss of rental or usable value of the property, increased financing costs, including interest on a construction loan, extended maintenance and operation expenses, and additional consultant fees. To the extent that the contractor is responsible for the delay, the owner is entitled to recover damages. Contract clauses, however, can be used to liquidate the damages that an owner may recover for delay as an alternate to the actual damages that the owner may suffer.

Many people erroneously characterize the liquidated damages provision as simply a penalty clause assessed against the contractor for not completing the work on time. They believe that if a contract does not include a liquidated damages provision, the contractor is not liable for delay damages the owner may suffer. However, just because a construction contract does not include a liquidated damages provisions does not mean that the owner is not entitled to recover its actual damages suffered due to delay. Liquidated damages provisions are used as an *alternative* to the owner's recovery of actual damages.

A. Definition of "Liquidated Damages"

Liquidated damages provisions specify a monetary amount per day that the owner is entitled to recover in damages if the contractor fails to complete the project by the contractual substantial completion date. The term, 'liquidated' is used to make certain and to signify the amount of damages an owner will recover in the event of a delay.

B. Purpose

> [T]he fundamental purpose of a valid liquidated damages provision is to provide the reasonable measure of compensation in the event of a breach where, at the time the provision is agreed to the damages are indeterminable or will be otherwise difficult to prove.
>
> See *24 Williston on Contracts* §65:3, at 250 (4th ed. 2002).

Actual damages for delay can be difficult to calculate and quantify. The inclusion of a liquidated damages provision in the contract can eliminate the lengthy and costly process sometimes associated with determining actual damages. However, the owner runs the risk of incurring greater actual damages than covered by the predetermined liquidated damages.

II. Enforceability of Liquidated Damages Clause

The inclusion of a liquidated damages clause does not always mean the provision is enforceable. The enforceability of a liquidated damages clause depends on multiple factors. If damages for delay are difficult to determine then the liquidated damages clause is typically upheld. However, if liquidated damages are a penalty or the owner caused/contributed to the delay, then liquidated damages will not be imposed. The following sections provide some considerations on determining if a liquidated damages clause can be enforced.

Title search: The Use and Enforceability of Liquidated Damage Clauses

Also available as part of the eCourse
Construction Law: Risk Management and Contract Issues

First appeared as part of the conference materials for the
2011 Construction Law session
"The Use and Enforceability of Liquidated Damage Clauses"