

## **Liquidated Damages: A Primer**

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**Litigation**

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Many property owners insist on a liquidated damages clause in their construction or renovation contracts as a motivator for project completion within a specified time.

Deadlines for the completion of construction projects are good for both owners and contractors. The owner wishes to use the finished product as soon as practical so that he or she may enjoy the benefits of its investment. The contractor who allocates resources to a project wants to ensure that those resources are earning an appropriate return. A delayed project can erode profits and prevent resources from being deployed elsewhere.

Liquidated damages are defined as a genuine pre-estimate of the probable loss that would be suffered from the late completion of a contract. In order to be enforceable, liquidated damages must not be a penalty. Liquidated damages will be considered to be a penalty if they are extravagant or oppressive in relation to the conceivable loss the owner would suffer from late completion. If liquidated damages are found to be a penalty, a Court will compensate the owner based on its actual losses.

The person arguing that liquidated damages are penal bears the onus of establishing this point. Owners will not be held to a standard of perfection. As long as the estimated amount of damages is reasonable, the clause will be enforceable. Courts recognize the utility and value of a fixed pre-estimate of damages because it saves the parties the time and expense of proving actual damages. Many contractors prefer the certainty of a fixed amount of damages if it cannot complete on schedule.

Market forces help ensure that liquidated damages are appropriately set. If the damages are set too high, contractors will not bid on a project or will inflate their bids as a safeguard, which in turn will drive up the cost of projects. If liquidated damages are set too low, a contractor may have an incentive to go over schedule if the prescribed damages are less than the acceleration costs to complete on time.

Numerous events beyond the control of the contractor can interfere with the completion of the contract within the specified time. As such, a contract with a liquidated damages clause must include provisions for extending the completion date in order for the clause to be enforceable. In the eyes of a Court, it would be unfair to charge liquidated damages without a mechanism that allows for extensions of time for events beyond the control of the contractor.

A prime example of external events causing a contract to take longer to complete are requests for extra work from the owner. Contract provisions for the extension of time to complete are as much for the benefit of the owner as the contractor, in that they adjust the completion date and thereby preserve the owner's right to claim liquidated damages if the project is not finished by the new completion date.

Requests to extend a contract completion date must be handled properly by an owner and its consultant. An owner will lose its right to claim liquidated damages if the owner or its consultant fails to respond to a contractor's request for an extension within a reasonable time after receiving the request. It is essential that the contractor knows the new date for completion because without this information a contractor cannot adjust its schedule and accelerate work if necessary. Liquidated damages must run from a specific date. Without a specific date they cannot be calculated and the clause will not be enforced by a Court.

The loss of the owner's ability to charge liquidated damages does not eliminate an owner's right to claim damages for late completion, but the test for late completion changes to proving a reasonable completion date and damages will be measured by actual losses and not a pre-estimate of damages.

It is important to review all contracts thoroughly before signing and appreciate their terms. In contracts that provide for liquidated damages, it is important to understand the provisions dealing with requests for extensions of time to complete in the event of intervening events that interfere with timely delivery. Properly documented requests for extensions for contract time, as well as insistence that consultants deal with these requests promptly, go a long way to avoiding disputes over liquidated damages charges and the end of a contract.

\* \* This article is intended only to inform and educate. It is **not legal advice**. Be sure to contact a lawyer to obtain legal advice on any specific matter.

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