

LIQUIDATED DAMAGES

Penalties and what is unenforceable

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Liquidated damages typically flow from delays, but they are not always solidly enforced.

In June 2017, a contractor agreed to construct a new park and elementary school for a City. The project included demolition of an existing park. The City did not want the neighborhood to go without a park for a long period of time. So, the contract included a deadline for completion and a liquidated damages (LDs) clause for delays beyond that deadline (\$1,000 per calendar day).

LDs clauses are commonplace in the construction industry. Such clauses provide parties a pre-defined remedy upon the occurrence or non-occurrence of an agreed event or condition. The most common event or condition is when a project milestone is not achieved and the parties have agreed to a daily amount to compensate the damaged party for loss of use and/or costs of extended project duration.

Some jurisdictions may require that LDs clauses be accompanied by incentive clauses. For example: (i) if a certain deadline is delayed, then the delaying party is responsible for \$X/day for each day of delay past the deadline, together with, (ii) if a certain deadline is achieved earlier than planned, then the achieving party will receive \$X/day for each day before the planned deadline.

Typically, LDs clauses are included when actual damages are difficult to determine, but they are capable of reasonable estimation and do not penalize the party responsible for the delay. LDs clauses will always be created before any conditions (e.g., delays) triggering LDs have occurred, not after-the-fact because, by that time, damages are better able to be determined.

Oftentimes, if parties have agreed upon an LDs clause and that LDs clause is later deemed unenforceable, the allegedly damaged party cannot then seek its actual damages. This is because, by the time a LDs clause is held unenforceable, the damaged party will have already taken the position that actual damages are difficult to determine and they cannot be reasonably estimated, so any later determination of actual damages will be less reliable.

Under Georgia Law, applicable to this case, LDs provisions are enforceable if: the damages will be "difficult to estimate accurately, the parties must intend to provide damages instead of a penalty, and the sum must be a reasonable estimate of the probable loss." *City of Brookhaven v. Multiplex, LLC*, 369 Ga. App. 9 (July 27, 2023).

In this case, the Court held the LDs clause was unenforceable because it was a penalty and it was not a reasonable estimate of the probable loss. A penalty is a disincentive, not compensation for damage or loss. A fee without a related damage is a penalty. Here, there was no cost or damage to the City by not being able to use the new park. While the inability of residents to use a neighborhood park is an inconvenience, it was not one that damaged the City by causing it pay or lose money. Hypothetically, if the City had set-up a temporary neighborhood park for a time-related cost and usage of that temporary park continued for longer than planned because the permanent park was completed late, then the City could have incurred a cost for the extended usage of the temporary park. Most often, parties simply expressly agree that an LDs clause is not a penalty, but that language was not in this contract.

An enforceable LDs clause must be a reasonable estimate of probable damage. Here, there was no evidence that \$1,000/day was based upon anything other than the "standard amount" in other City contracts. But even if there had been some evidence of an estimate, the basis must be reasonable. For example, if the daily amount included fixed costs that would have been incurred regardless of any delays, then at least the amount would probably have been unenforceable and maybe the entire LDs clause.

LDs clauses are usually enforceable. But if they are unreasonable or penalize, they will fail.

