



CONSTRUCTION
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Liquidated Damages and Stipulated Sums – You don't know as much as you think

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Liquidated Damages - Basics

- What are they?
- Damages versus Penalties
- Liquidated Damages versus Stipulated Damages
- Legal tests
- Incentive payments
- Disincentive payments
- Lane Closure Charges
- Reverse Liquidated Damages for Owner Delay

Liquidated Damages – Hornbook

- Liquidated Damages per *Williston*
 - Under the fundamental principle of freedom of contract, the parties to a contract have a broad right to stipulate in their agreement the amount of damages recoverable in the event of a breach, and the courts will generally enforce such an agreement, so long as the amount agreed upon is not unconscionable, is not determined to be an illegal penalty, and is not otherwise violative of public policy. *Williston § 65.1*
 - It is generally agreed that a liquidated damage provision does not violate public policy when, at the time the parties are entering into the contract containing the clause, the circumstances are such that actual damages likely to flow from a subsequent breach would be difficult for the parties to estimate or for the non-breaching party to prove, and the sum agreed upon is designed merely to compensate the non-breacher for the other party's failure to perform. *Id.*

Liquidated Damages Basics (con't)

- On the other hand, a liquidated damage provision will be held to violate public policy, and hence will not be enforced, when it is intended to punish, or has the effect of punishing, a party for breaching the contract, or when there is a large disparity between the amount payable under the provision and the actual damages likely to be caused by a breach. . . *Id.*

Damages versus Penalties

- If the clause rather than establishing damage that approximate or are proportional to the harm likely to flow from a particular breach, it actually constitutes a penalty, and, since penal clauses are general unenforceable, provisions having this effect are declared invalid. *Id.*
- Keep in mind that if you are successful in getting a Court to throw out a liquidated damage clause is does not mean no damages
 - They can still seek actual damages
 - Normally, this is not much unless you are involved with a revenue producing facility, such as a toll road, casino or hospital

Rewards versus Penalties

- Rewards – Okay
- Penalties – Void as against Public Policy

NJ Decisions – Westmount CC v Kamney

- *Westmount Country Club v. Kamney, 197 A2d 379, 82 NJ Super 200 (App Div 1964)*
- Silvia Pressler represented Kamney
- Case involved Country Club seeking to hold \$850 when Kamney decided to leave the Club
- Motion to Compel answers to Interrogatories

Westmount CC v. Kamney (con't)

- Kamney left a Country Club mid-season and the Club wanted to charge him for the full year
- Liquidated damages is the sum a party to a contract agrees to pay if they break some promise, and which, having been arrived at by a good faith effort to estimate in advance the actual damages that will probably ensue from the breach, is legally recoverable as agreed damages if the breach occurs. *Id at 382.*
- A penalty is a sum a party agrees to pay in the event of a breach, but which is not fixed, not as a pre-estimate of probable actual damages, but as a punishment, the threat of which is designed to prevent the breach. *Id at 382.*

Westmount CC v. Kamney (con't)

- Two-prong test
 - An agreement made in advance of breach, fixing the damages thereof, is not enforceable as a contract and does not affect the damages recoverable for a breach, unless
 - (a) the amount so fixed is a reasonable forecast of just compensation for the harm that is caused by the breach, and
 - (b) the harm that is caused by the breach is one that is incapable or very difficult of accurate estimate. *Id at 382.*

Wasserman's Inc. v. Township of Middletown

- *Wasserman's Inc. v. Middletown, 645 A2d 100, 137 NJ 238 (1994)* – Opinion by Justice Pollock (Wilentz, Clifford, Handler, O'Hern, Garibaldi and Stein concurring)
- Cancellation clause in a lease – seeking \$346,058.44, plus interest, seeking payment of all remaining rental payments for remainder of the cancelled lease per the terms of the lease
- Sent back to determine actual damages

Wasserman's Inc. v. Township of Middletown (con't)

- Much discussion on whether stipulated/liquidated damages clauses should be enforceable at all – or should a party simply be entitled to recover actual damage caused by the breach
 - Some states do not recognize stipulated/liquidated damages
 - Consistent with the principle of reasonableness, New Jersey courts have viewed enforceability of stipulated damages clauses as depending on whether the set amount “is a reasonable forecast of just compensation for the harm that is caused by the breach” and whether the harm “is incapable or very difficult of accurate estimation.” *Id at 106-107*

Wasserman's v Middletown (con't)

- Liquidated damage clauses are prima facie valid. The burden is on a party challenging same to show them to be unreasonable. *Id at 108*
- The purpose of a stipulated damage clause is not to compel the promisor to perform, but to compensate the promisee for non-performance. *Id at 108*
- The decision whether a stipulated damage clause is enforceable is a question of law for the Court. *Id at 110*

Wasserman's v. Middletown (con't)

- Although the Appellate Division has indicated that courts should determine the enforceability of a stipulated damage clause as of the time of the making of the contract, the modern trend is towards assessing reasonableness either at the time of contract formation or at the time of the breach. *Id at 107*
- Quoting *Calmar & Petrillo*, “there are two moments at which the liquidated damages clause may be judged rather than just one.”

MetLife Capital v. Washington Ave Assoc.

- *MetLife Capital v. Washington Ave. Association, 732 A2d 493 (159 NJ 484) (1999)* – Judge Garibaldi
- Defaulted Loan provided for a 5% late charge is it valid?
 - An agreement made in advance of breach, fixing the damages, therefore, is not enforceable as a contract and does not affect the damages recoverable in a breach, unless (a) the amount so fixed is a reasonable forecast of just compensation for the harm that is caused by the breach, and (b) the harm that is caused by the breach is one that is incapable or very difficult of accurate estimation. *Id at 498*
 - Citing *Restatement*, Damages for breach by either party may be liquidated in the agreement but only at an amount that is reasonable in light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss. A term fixing unreasonable large liquidated damages is unenforceable on grounds of public policy as a penalty. (at 499)

MetLife (con't)

- Treating reasonableness “as the touchstone,” we noted that the difficulty in assessing damages, intention of the parties, the actual damage sustained, and the bargaining power of the parties all affect the validity of a stipulated damage clause. *Id at 499*
- We leave it “to the sound discretion of the trial court the extent to which additional proof is necessary on the reasonableness of the clause. . . .We will look to the “totality” of the circumstances. *Id at 499*

NJDOT – Liquidated Damages

- NJDOT – Old
- NJDOT - New

NJDOT – Liquidated Damages - Historically

- Old School – Based on a simple table

**Schedule Of Liquidated Damage For Each Day Of
Overrun in Contract Time**

Original Contract Amount		Liquidated Damages	
From More Than	To and Including	Calendar Day or Specific Completion Date	Working Day
\$ 0	\$ 25,000	\$ 45	\$ 63
25,000	50,000	75	105
50,000	100,000	110	154
100,000	500,000	150	210
500,000	1,000,000	225	315
1,000,000	2,000,000	300	420
2,000,000	5,000,000	450	630
5,000,000	10,000,000	600	840
10,000,000	—	700	980

NJDOT – Liquidated Damages

- Prior to award of Contract – Make a determination as to amount of actual damage
- Two major components
 - Estimate of Costs for Field and Office Inspection (both NJDOT and Consultants)
 - Road User Costs

Road User Costs

- Latest artifice being used to build up the claimed amount of liquidated damage for non-revenue projects such as most roadways
- Concept – NJDOT is seeking damages for vehicles/trucks that due to the construction work now take a longer time to transit the project site – dollar quantification of same
 - Are they really NJDOT damages?
 - Many of the drivers are from other states
 - What if there is no actual backup/slowdown of traffic?

Treatment of Liquidated Damages outside the United States

- Civil law jurisdictions tend to regard penalties as enforceable do not distinguish between penalty clauses and liquidated damages clauses
 - Chedrawe, Joseph, ‘Liquidated Damages for Delay in the Middle East: Not Etched in Stone’. *BCDR International Arbitration Review* 4, no. 1 (2017): 99–112.)
- United Kingdom Supreme Court decision *Makdessi v Cavendish Square Holdings BV*, 2015 WL 6655167 (2015)

Makdessi v Cavendish Square Holdings BV, 2015 WL 6655167 (2015)

- Citing House of Lords in Export Credits Guarantee Department v Universal Oil Products Co [1983] 1 WLR 399 (“ECGD”):
 - “[P]erhaps the main purpose, of the law relating to penalty clauses is to prevent a plaintiff recovering a sum of money in respect of a breach of contract committed by a defendant which bears little or no relationship to the loss actually suffered by the plaintiff as a result of the breach by the defendant. But it is not and never has been for the courts to relieve a party from the consequences of what may in the event prove to be an onerous or possibly even a commercially imprudent bargain.”

Variants of Liquidated Damages

- Stipulated Sums
- Incentives
- Disincentives
- Lane Rental/Occupancy Charges
- Reverse Liquidated Damages – Payment by Owner in case of Owner Caused Time Impact

Incentive Bonus Payments

- Bonus for completing project earlier than contractually required
- May attach to substantial completion, partial completion, or multiple milestones
- May be lump sum payment for meeting single date, or per-day bonus for each day earlier than specified date
- May include overall cap on bonus payment

Incentives v Liquidated Damages

2009					2010					2011					2012																						
J	A	S	O	N	D	J	F	M	A	M	J	J	A	S	O	N	D	J	F	M	A	M	J	J	A	S	O	N	D	J	F	M	A	M	J	J	A
 Incentive Bonus Contract 8/11 Amendment Signed																																					
Milestone #1					 3/10 \$60,000/day					\$5,000/day																											
Milestone #2					 3/15 \$60,000/day					\$5,000/day																											
Milestone #3					 4/8 \$60,000/day					\$5,000/day																											
Milestone #4					 5/15 \$60,000/day					\$5,000/day																											
Milestone #5					\$60,000/day					 1/13 \$5,000/day																											
Milestone #6					\$60,000/day					 10/8 \$5,000/day																											
Milestone #7					\$60,000/day					 6/14 \$6,000/day																											
J	A	S	O	N	D	J	F	M	A	M	J	J	A	S	O	N	D	J	F	M	A	M	J	J	A	S	O	N	D	J	F	M	A	M	J	J	A
2009					2010					2011					2012																						

Incentives v Liquidated Damages

2009					2010					2011					2012										
J	A	S	O	N	D	J	F	M	A	M	J	J	A	S	O	N	D	J	F	M	A	M	J	J	A
 Incentive Bonus Contract 8/11 Amendment Signed					<div style="border: 1px solid black; padding: 5px;"> Legend:  Milestone Completion Date  Early Milestone Completion  Late Milestone Completion </div>																				
Milestone #1					  9 CDs early +\$540,000 3/1 3/10																				
Milestone #2					  24 CDs late -\$120,000 3/15 4/8																				
Milestone #3					  16 CDs late -\$80,000 4/8 4/24																				
Milestone #4					   161 CDs late -\$805,000 5/15 10/23																				
Milestone #5					412 CDs late -\$2,060,000    1/13 2/29																				
Milestone #6					   119 CDs early +\$8,820,000 6/11 10/8																				
Milestone #7					384 CDs late -\$2,304,000    6/14 7/2																				
J	A	S	O	N	D	J	F	M	A	M	J	J	A	S	O	N	D	J	F	M	A	M	J	J	A
2009					2010					2011					2012										

Incentive Bonus Payments

- Not covered by no damage for delay
 - Trocom Const. Corp. v. City of New York, 51 A.D.3d 533 (2008)
 - Nigro Bros., Inc. v. New York State Thruway Authority N.Y.S. 2d (1998) 1998 WL 1181900
- Covered by pay-when-paid clauses
 - Moore Bros. Co. v. Brown & Root, Inc., 207 F.3d 717 (4th Cir. 2000)

Incentive Bonus Payments

- Excusable time extensions (non-compensable) would entitle contractor to time extension to compensable bonus
 - Amitech U.S.A., Ltd. v. Nottingham Const. Co., 2009-2048 La. App. 1 Cir. 10/29/10, 57 So. 3d 1043, 1065 (La. Ct. App. 2010), reh'g denied (Mar. 28, 2011), writ denied, 2011-0866 La. 6/17/11, 63 So. 3d 1036 and writ denied, 2011-0953 La. 6/17/11, 63 So. 3d 1043

Incentive Bonus Payments

- Typically cannot allow owner to prevent contractor from achieving bonus if owner responsible for delay
 - Edward Kraemer & Sons, Inc. v. City of Overland Park, 19 Kan.App.2d 1087 (1994)
 - Appeal of Murphy Bros., Inc., 86-2 BCA P 18774 (1986)
- Varies by jurisdiction

Incentive Bonus Payments

- Ray Bell Const. Co., Inc. v. State, Tennessee Dept. of Transp., 356 S.W.3d 384 (Tenn. 2011)
 - Contract included clause that completion date may be extended, but “no incentive payment will be made if work is not completed in its entirety by December 15, 2006”
 - Ray Bell delayed due to TDOT bridge closing and other excusable delays
 - TDOT refused to extend incentive date due to contract language

Ray Bell Const. Co., Inc. v. State, Tennessee Dept. of Transp., 356 S.W.3d 384 (Tenn. 2011)

- Claims commission entered judgement for Ray Bell for full value of incentive bonus
- Tennessee Court of Appeals affirmed
- Supreme Court of Tennessee overturned, finding that clause was unambiguous, no need for extrinsic evidence

Incentives versus Disincentives

- Major issue as to “disincentives,” which are per se penalties
- *Milton Construction Company v. State of Alabama Highway Department (Milton I)*, 568 So2d 784 (AL 1990)
- Contract provided for \$5,000/day in “disincentives” to a maximum of 60 days (\$300,000)
- Seeking to declare the “disincentive” portion of a clause to be invalid as a penalty
- Contract also separately provided for liquidated damages
- Found disincentives invalid as a penalty
- Fact that contractor had previously accepted incentives was not of any consequence

Milton I

- The purpose of the incentive/disincentive clause was to ensure “the earliest possible date for completion of the project” – it was not intended to be compensation for any delay. *Id at 791*
- Highway Dept admitted that they arbitrarily set the dollar amount of the per-day assessment and the maximum time limit. *Id at 791*

Milton II

- *State of Alabama Highway Department v. Milton, 586 So2d 872 (AL 1991)*
- Following remand, trial court granted contractor Summary Judgment and AHD appealed. AHD also sought to file an amended counterclaim, which was denied.
- AHD now sought “road user costs” defined as the “daily cost of the traveling public due to delays cause by the contractor.” Sought \$30,000 to \$40,000 per day of delay.
- Seeking actual damages, i.e road user costs
- Denied, indeed granted our cross-appeal for interest

Milton II (con't)

- Although the Highway Department can not recover user costs in this case, we do not foreclose the possibility that the Highway Department may recover such costs caused by contract delays in highway construction contracts where the contract allows for such damages and those damages do not constitute a penalty.

Lane Closure Charges

■ Section 108.19 – Lane Occupancy Charges

- The phrase “lane closure limit” as used herein shall refer to the time period for lane openings as set forth in the Contract Documents. The Contractor is advised that time is of the essence as to all the lane closure limits during which a lane or lanes of the Traveled Way may be closed by the Contractor to perform the Work. In the event that the Contractor fails to open a lane or lanes of the Traveled Way according to the lane closure limits, the Department will have the right to collect a Lane Occupancy charge for the use and occupancy of each such lane or lanes beyond the permitted time period until such time that the lane or lanes are reopened to traffic or until such time that the lane closure is allowed to take place again under the lane closure limit.
- Traffic being backed up as a result is not a requirement
- Charges of \$250 per minute – again whose damage?

Reverse Liquidated Damages

- Provides amounts for payment to the Contractor if delayed due to Owner

109.04 Payment for Contractors Expenses During Delays

DELETE THE ENTIRE ARTICLE AND SUBSTITUTE THE FOLLOWING:

In the event the Owner is responsible for a delay not absolved by the exculpation features of the no damage clauses of these conditions, the Owner and the Contractor agree that the following schedule shall constitute the agreed upon damages between the parties, said amount to be considered liquidated damages and not a penalty.

Schedule of Expenses During Delays

<u>Original Contract Amount</u>		<u>Expenses</u>	
<u>FROM MORE THAN</u>	<u>TO AND INCLUDING</u>	<u>PER CALENDAR DAY</u>	<u>PER WORKING DAY</u>
\$ 0	\$ 25,000	\$ 100	\$ 145
25,000	50,000	175	210
50,000	100,000	250	315
100,000	500,000	350	420
500,000	1,000,000	500	630
1,000,000	2,000,000	750	840
2,000,000	---	1,000	1,260

Reverse Liquidated Damages (con't)

- Successfully got the Court to focus on *Wasserman* test
- Successful in getting Court to deny Motion for Partial Summary Judgment brought by Owner
 - Court found that the amounts in table were not reasonable based on actual damages experienced by contractor

Some thoughts

- Can you get Liquidated Damages and also get paid Actual Damages?
 - Maybe, fact sensitive
 - Depends on the basis of the LDs
- What if the amount of LDs is set too low by the Owner in its Contract compared to the Owners actual damages?
 - Contraproferendum
- Does payment for same bar claims for contribution or indemnification from the Owner for the same delay – say Owner gets claim for time impact from a follow-on Contractor
 - Most likely, yes. Contraproferendum

Some thoughts

- Subcontractor Concerns
 - Is obligation limited to reimbursing GC for the LDs it must pay to the Owner?
 - What if GC accelerated its work to avoid LD liability to Owner?
- Limit of LD Liability
 - What happens if you reach cap? Termination?
- LDs for issues unrelated to delay.
 - Safety
 - Performance Guarantees
 - MBE utilization
- Clawback of payment of interim milestone LDs.



Questions?

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