

Liquidated Damages in Construction Contracts: How to calculate LDs so they're enforceable

Many construction contracts have LD clauses. LD clauses can benefit the owner of the property by imposing damages against the contractor for failure to complete on time; and LD clauses can also benefit the contractor in the event the owner terminates the contract prior to completion. LDs are a method of calculating anticipated damages in advance and not having to argue about actual damages later on.

In the Court of Appeals decision in *Young v. Allen Homes* (September 2022), the court held that an LD clause is enforceable if it is intended to compensate the non-breaching party as opposed to penalizing the breaching party. An LD clause must be an amount that is reasonable in light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss. The damages cannot be speculative and must be based on some measure of what the loss might be.

Allen Homes' contract contained an LD clause providing that the \$80,000 deposit to be paid by the homeowners would be nonrefundable if the owners canceled the contract at any time. This is a method of measuring damages called anticipated loss (or how much the contractor believes it will lose if the contract is cancelled prior to completion).

The other method of measuring damages is actual loss: the amount the contractor actually loses as a result of the cancellation.

The court found there was not enough evidence to support the contractor's claim that it suffered \$80,000 in damages from the cancellation. Since the \$80,000 LD applied whether the contract was cancelled on Day 1 or Day 100, there was no way to determine if \$80,000 was a reasonable amount. The Court of Appeals sent the case back to the trial court to determine whether the contractor could prove the reasonableness of the LD amount.

In determining your LD amount, you should do two things: One, calculate the likely damages you'll incur if the project is canceled early. For instance, how much money will you be out for general conditions and prep time on pre-construction work along with how much money you might lose for not taking other work. Put these calculations in writing and keep them in the job folder in the event you need to produce evidence of how you came up with your LD amount.

Two, keep track of actual damages incurred from the cancellation. Those actual damages can be used later to support your claim that the LD amount was reasonable.