

DAMAGE CLAUSES – ARE THEY ENFORCEABLE?

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When two parties have entered into an agreement and set out the terms in writing, the courts will, in most cases, hold the parties to the terms of the written contract. But one kind of contractual clause—liquidated damages—is subject to judicial scrutiny and may be ruled unenforceable. A liquidated damages clause is a term in a contract which sets the amount of damages payable by an offending party to the other if it has breached the agreement. For example, the parties to a construction contract may attempt to fix the damages payable for failing to meet a completion date with a clause like this: “If the Project is not complete on February 15, 2004, the Contractor will pay damages to the Owner in the amount of \$200 per day until completion of the Project.”

Contracts have this kind of clause so that both parties know the consequences of a breach of the agreement without having to incur the time or expense of having the amount of damages determined by a court. As a general rule, the courts will not interfere with a liquidated damages clause if the stipulated sum bears some relation to the loss that is likely to result from the contractual breach and is not harsh or excessive; they uphold the clause and award the amount of damages specified.

Courts recognize, however, that it can be difficult for parties to predict at the time of entering an agreement all the damages that an injured party might incur. For that reason, the courts do not impose a high standard when reviewing the validity of a liquidated damages clause. Although the stipulated amount may be more than the damages actually suffered, this is not sufficient grounds for setting aside a liquidated damages clause. However, if the party who breached the contract can demonstrate that the damages provision is not only excessive, but unreasonable or punitive because it bears little or no relation to the loss actually suffered, a court may strike down the clause and make its own determination of the amount of damages payable.