

CASEBRIEFS

The Understanding Video Lecture Series™

Liquidated Damages

What are they?

- A liquidated damages clause is a provision, placed in the contract itself, specifying the consequences of the breach.
- For example, a contractor agrees to paint the Owner's house for \$10k, in the K, all parties agree that for every day after the deadline that the contractor finishes, the price will be reduced by \$100.

General Rule

- Courts will only enforce liquidated damages if the court is satisfied they are not a penalty.
- In order for the clause to be enforceable, it must be
 - A reasonable forecast, meaning reasonable relative to the anticipated or actual loss for the breach
 - And, in some courts, the harm caused by the breach must be uncertain, or difficult to calculate.

Reasonableness

- Most courts will enforce the clause if either 1) the clause is a reasonable forecast when viewed as of the time of contracting or 2) the clause is reasonable in light of the ACTUAL damages which have occurred.

Hypo: “No trip for you”

On 1/1, Consumer signs K w/ Travel, a travel packager, to take Tahiti vacation for \$10K starting 2/1.

Consumer puts down \$3K deposit.

Contract says, “Deposit is forfeited if customer cancels for any reason after 1/23.”

Travel has limited # of Tahiti reservations available for 2/1.

Travel makes \$3K gross profit per trip, on average.

Consumer cancels on 1/26.

Travel gives that reservation to X for same \$10K. Unclear whether Travel could have sent Consumer and X both on 2/1.

Can Travel keep the \$3K deposit?

Answer: Liquidated Damages and Penalties

- Yes. Liquidated damages clause is invalid if it's deemed to be a penalty.
- Will not be considered a penalty if it's both:
 - (1) reasonable forecast of loss as of making of K; and
 - (2) actual damages turn out to be tough to measure.
- Here (1) is reasonable forecast
 - Measures P's gross profits, and takes into account possibility of late cancellation and unusable slot;
- and (2) is satisfied
 - difficulty of proving whether extra Tahiti slot would have been available to house both X and Consumer
 - (so maybe Travel could have sent both & lot 1 net sale).

Let's try another

- Ian contracts to have a 4 bedroom house built by Bob, and the contract stipulates that it should be done by May 1st, and if not, Ian may recover \$500 for every day that Bob is late
- Is this a reasonable liquidated damage?

Maybe

- What factors would we consider? What would Ian's damages be?
 - Hotel (does he need multiple rooms?)
 - Storage
 - Eating out instead of kitchen
 - Is he incurring costs by a delayed move?