

RECOVERABILITY OF LIQUIDATED DAMAGES

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A WSPE member recently inquired as to the enforceability of liquidated damages in Wisconsin. For example, if liquidated damages are reasonably calculated and based on an engineer's good faith estimate as to additional costs in the event a project is not completed on time, may those damages be recovered? The concern from the owner and engineer's perspective is that the contractor will not be motivated to finish the job on time if the liquidated damages are so low that it becomes cost effective for the contractor to pay the damages in lieu of timely mobilizing a crew.

Wisconsin law provides that contract provisions calling for liquidated damages are generally enforceable, provided the amount of damages reflects a fair and reasonable effort at estimating the actual amount of damages which likely would result from a failure to finish the project on time. Wassenaar v. Panes, 111 Wis. 2d 518, 331 N.W.2d 357 (1983). However, Wisconsin courts will not enforce liquidated damages provisions which have no substantive relationship to the actual amount of damages likely to be incurred and are solely intended to punish the breaching contractor for failing to finish the job. In determining whether a liquidated damages provision is reasonable, courts will consider whether the amount of damages is reasonable in light of the anticipated or actual harm caused by the breach, the difficulty or impossibility of accurately estimating the amount of damages at the time the contract is signed, and whether the parties intended to provide for a penalty or for liquidated damages. Id. Rainbow Country Rentals and Retail, Inc. v. Ameritech Publishing, Inc., 2005 WI 153, 286 Wis. 2d 170, 706 N.W.2d 95.

Courts will typically review a liquidated damages provision with the presumption that the terms are reasonable unless the breaching party establishes the unreasonableness and penal nature of the clause. In other words, the contractor will have the burden of persuading the court that the liquidated damages provision is a penalty. The issue of whether a liquidated damages provision is reasonable is a question of law that a judge will decide rather than a jury.

To maximize the likelihood that a liquidated damages provision will be enforced, the owner and engineer should make a reasonable effort to estimate upfront what expenses are likely to be incurred in the event of a contractor's breach. Such estimating should be conservative, but not so extreme that it contemplates events which are very unlikely to occur. Documentation which demonstrates the owner's efforts to estimate the anticipated damages will increase the likelihood that those provisions will be enforced in court. Even if the actual damages differ from the original estimates, as long as the parties made a good faith effort to estimate the anticipated damages, the liquidated damages should be recoverable.