

## **When Liquidated Damages Can and Cannot Be Enforced**

by Bernard S. Kamine

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Every public works project that overruns the contract time, as extended, enters into the realm of liquidated damages. There are many reasons why liquidated damages may not be enforced, but they generally involve just a few legal concepts: (1) Whether any damages actually were suffered; (2) Whether the prescribed liquidated damages meet minimum requirements for reasonableness; (3) Whether the contract language requires the all-or-nothing or apportionment-of-delay analysis; (4) Whether liquidated damages are barred by acts or omissions of the owner which prevented timely performance, amount to a waiver, or estop the owner from enforcing the liquidated damages provision.

### **Actual Damages and Reasonableness**

Before there can be any liquidated damages, there have to be actual damages. The actual damages must result from a delay in putting the project into operation. In other words, since actual damages resulting from delay cease when the project is complete enough to perform its intended function and the agency takes possession and starts using it, then liquidated damages must also cease at this point. Liquidated damages cannot be a penalty for the agency to club the contractor into compliance with punchlist, warranty, paperwork or other requirements that do not affect the use of the project as contemplated by the contract.

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Moreover, liquidated damages must be a reasonable attempt to approximate the actual damages. That attempt is judged as of the date the contract was signed. For example, if a storm drain is not completed on time, the agency suffers by having to provide alternative means to deal with storm water, plus possible extended inspection costs. The liquidated damages must be a forward-looking attempt, as of the day the contract was signed, to estimate what the dollar amount of those actual damages would be. If the liquidated damages are unreasonable under that forward-look, they are not enforceable at all (Civ. Code § 1671, Pub. Cont. Code § 10226 [State Contract Act], Gov. Code § 53069.85 [local agency public works]). Another example, liquidated damages that may be appropriate for a project as a whole would generally not be reasonable during a plant establishment period, after all other work was completed. Such liquidated damages could easily amount to a disfavored forfeiture (Civ. Code §§ 1442; *Hawley v. Orange Co. Flood Control Dist.* (1963) 211 CA2d 708, 713, 27 CR 478; *Brawner v. Wilson* (1954) 126 CA2d 381, 385, 271 P2d 397).

### **The All-or-Nothing Approach**

The standard judicial approach to liquidated damages, in any kind of contract, is all-or-nothing (5 Williston on Contracts (3d ed. 1961) pages 764-66). It is the approach used with construction contracts that contain provisions for only (a) completion by a particular date and (b) liquidated damages for overrunning that date – in other words, contracts with no provisions for extending the completion date for events beyond the contractor’s control. The first

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public works contracts reviewed by California appellate courts were of this type, and the all-or-nothing approach to liquidated damages was applied.

In *Gogo v. Los Angeles County Flood Control Dist.* (1941) 45 CA2d 334, 114 P2d 65, the contractor overran the completion date by 249 days. In the absence of contract language prescribing conditions under which the completion date would be extended, the district's chief engineer (relying on this contract provision: "On all questions relating to ... the proper execution, progress or sequence of the work ... the decision of the Chief Engineer shall be final and binding") waived 113 days of liquidated damages (for district actions preventing site access, for excavation extra work and for inclement weather). However, the trial court remitted all 249 days of liquidated damages. On appeal, the district sought the liquidated damages for that part of the overrun not waived by the chief engineer. The court held, at 45 CA2d 344-45:

In making this contention defendant [district] seeks to have this court apportion the amount of delay attributable to each [Gogo and the district] and to fix damages accordingly. The correct rule is that where such delays are occasioned by the mutual fault of the parties the court will not attempt to apportion them but will refuse to enforce the provision for liquidated damages. [out-of-state citations] ... It follows that plaintiffs were properly awarded the total amount of liquidated damages withheld by defendant.

In *Peter Kiewit Sons' Company v. Pasadena City Jr. College Dist.* (1963) 59 C2d 241, 245, 28 CR 714, 379 P2d 18, the supreme court confirmed that:

**[I]n the absence of a contractual provision for extensions of time**, the rule generally followed is that an owner is precluded from obtaining liquidated damages not only for late completion caused entirely by him but also for a delay to which he has contributed, even though the contractor has caused some or most of the delay. [boldface added]

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The all-or-nothing approach is appropriate when the contract fails to prescribe the conditions or events that determine which party is responsible for what delays in the project. For example, absent a contract provision defining the weather risk and allocating it between the parties, upon what standard did the chief engineer in *Gogo* (or could a court in subsequent litigation) apportion that risk? The same obtains for many other risks attendant to public works construction (*e.g.*, earthquake, fire, labor disputes, shortage of materials, freight embargoes and government actions during emergencies or war).

### **The Apportionment-of-Delay Approach**

When a contract prescribes events and conditions for which the original contract completion date must be extended, the contract, itself, provides a mechanism to apportion responsibility between the parties for any overrun of the date: If delay results from specified events or conditions, the agency must extend the contract time, thereby apportioning delay. The courts can and will enforce that specific contract language by determining responsibility for discrete delays under the standards established in the contract. The court's analysis starts at the contractor's apparent breach of contract by overrunning the original contract completion date (for this breach the agency is entitled to damages, usually liquidated damages at a specified daily rate). Then the inquiry turns to the agency's breaches by failing to properly extend the contract completion date. Sometimes the court must first determine whether one of the specified events or conditions occurred, *e.g.*, did the public agency really order extra work for which a change order should have been issued, including an appropriate time extension. This analysis of discrete

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delays under the standards established in the contract often results in a remission of some or all of the liquidated damages withheld by the agency.

The first California case to discuss apportionment of delay was *Nomellini Construction Co. v. State ex rel. Dept. of Water Resources* (1971) 19 CA3d 240, 96 CR 682. There, on a contract to build portable houses, the liquidated damages were \$10/house/day. The overrun was 6840 house/days. Pursuant to the contract, the state gave Nomellini 2440 house/days in extensions, leaving 4400 house/days of liquidated damages. Nomellini sued for remission of all liquidated damages. The trial court analyzed the delays, determined that the state not Nomellini was responsible for all of the delays, and remitted all liquidated damages. The appellate court reversed, holding (at 19 CA3d 246-47): “On the record as it has been represented to this court by the parties in their briefs and in their arguments there were no disallowed delays for which Nomellini was not responsible.” Then the court went on (19 CA3d 245-46):

Assuming arguendo *contrary to our holding* that there were delays which the Department should have allowed, they were delays which the trial court would have been obligated to apportion.

The controlling law is found in ... *Robinson v. United States*, 261 U.S. 486 [67 L.Ed. 760, 43 S.Ct. 420]. That case involved a **contract which provided for both liquidated damages and extensions of time...** . In holding that apportionment was proper the court stated at page 488 [67 L.Ed. at page 762]: ... “The law required that some provision for liquidated damages be inserted ... . The fact that the government’s action caused some of the delay presents no legal ground for denying it compensation for loss suffered wholly through the fault of the contractor ... .” This holding ... did not announce a unique or novel principle. 5 Williston on Contracts (3d ed. 1961) pages 764-766, states: “Where both parties are in fault a party who has contributed to the breach cannot recover a sum stipulated as liquidated damages, even though performance of the contract is continued, and the other party is thereafter at fault: ... In **building contracts**, there is often inserted a **provision** giving the

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architect power to certify an **extension of time** in certain cases, by virtue of which the effect of a delay caused by the owner operates merely as an extension of the time of performance, and a new time is substituted for the old. In that event though the owner causes delay the builder is liable in liquidated damages, but the period of delay caused by the owner is deducted from the total delay. **Unless the contract contains such a provision the delay due to each party will not generally be apportioned.**" [italics in the original; bold face added]

In other words, when the contract prescribes events and conditions for which the original contract completion date must be extended, the courts enforce this language by inquiring into every delay to determine whether it qualifies under the contract language for a time extension. For example, when a contract provision defines the weather risk and allocates it between the parties, it is that contract standard which a court enforces by apportioning weather delays accordingly. The same obtains for all of the other risks that are allocated by the contract time extension clause. The same also obtains for all delays arising out of owner breaches of the contract, *e.g.*, interference with the contractor's work on controlling operations.

### **The Waiver/Estoppel/Prevention Theories**

Independent of the all-or-nothing and apportionment-of-delay approaches are equitable doctrines and principles of contract law that can also impact liquidated damages. These doctrines and principles often overlap with each other and with the two approaches to liquidated damages.

Either party to a public works contract can be prevented from relying upon any requirement in the contract by the equitable doctrine of estoppel (*e.g.*, *Maurice L. Bein, Inc. v. Housing Authority* (1958) 157 CA2d 670, 678-82, 321 P2d 753 [authority estopped from

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enforcing both a clause precluding damages for delay and a clause limiting the remedy for agency-caused delay to just an extension of contract time, *i.e.*, limiting the remedy to just an abatement of liquidated damages]). Thus, an agency can be estopped from enforcing the liquidated damages clause.

Similarly, either party to a public works contract can waive any benefit under the contract (*Weeshoff Constr. Co. v. Los Angeles County Flood Control Dist.* (1978) 88 CA3d 579, 589, 152 CR 19 [district waived written change order requirement by forcing Weeshoff to do extra work, yet refusing to admit it was extra work]; *accord, Bettelheim v. Hagstrom Food Stores, Inc.* (1952) 113 CA2d 873, 878, 249 P2d 301 [lease provision prohibiting waivers not made in writing was, itself, waived; “[e]ven a waiver clause may be waived by conduct.”]). Once a right is waived, it generally cannot later be asserted (*Carmel Valley Fire Protection District v. State of California* (1987) 190 CA3d 521, 534, 234 CR 795 [“A right that is waived is lost forever”]). Thus, an agency can waive all or part of its liquidated damages.

Given appropriate facts, the estoppel or waiver doctrines will apply and result in a reduction of liquidated damages assessed by an agency. For example, when an agency causes delays, pushing the work beyond the contract completion date, it could thereby be estopped from enforcing that date and recovering liquidated damages, or its conduct could amount to a waiver of the contractor’s breach by overrunning the completion date and the corresponding liquidated damages.

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Acts or omissions of the agency also can prevent the contractor from completing performance within the contract time. Civil Code § 1511 provides:

The **want of performance** of an obligation [*e.g.*, completion by the contract completion date] ... in whole or in part, **or any delay therein is excused** by the following causes ... [¶] 1. When such performance... is **prevented or delayed** by the act of the creditor ... even though there may have been a stipulation that this shall not be an excuse ... . [boldface added]

A public agency is such a “creditor” (*Peter Kiewit Sons’ Company, supra*, 59 C2d at 243-44).

This excuse/prevention principle is actually the underlying theoretical support for both the all-or-nothing and apportionment-of-delay approaches. The delays for which the agency is responsible prevent or delay completion by the original contract completion date. That is why completion by that date is excused, and liquidated damages remitted – either all of them (because there is no vehicle in the contract to apportion them) or the apportionable amount (according to the terms of the contract).

On the other hand, neither the all-or-nothing approach nor the apportionment-of-delay approach is the **only** application of the excuse/prevention principle. Nor do they affect the doctrines of estoppel or waiver. There are many other applications of the excuse/prevention principle, some of which impact upon liquidated damages issues. As *Kenworthy v. State of California* (1965) 236 CA2d 378, 382, 46 CR 396, points out:

In *Peter Kiewit Sons’ Co. v. Pasadena City Junior College Dist.*, 59 Cal.2d 241 [28 CR 714, 379 P2d 18], it was held that where a contractor is delayed in the construction of a building by acts of the owner, he is entitled to an extension of time to complete equal to the delay. Although this rule was stated in a case in which the question was whether the contractor was relieved from the burdens of a liquidated damage provision of a contract, **the reason for the rule**

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**should be equally applicable to any case where a question of the contractor's excuse for nonperformance within a time fixed by the contract is properly raised.** [boldface added]

### **Ordering New Work After the Extended Completion Date**

Most public works contracts allow the agency to modify the plans and specifications by issuing change orders, including appropriate extensions to the contract completion date. As is noted above, determining whether a change order requires an extension of the contract time is usually an application of the apportionment-of-delay approach.

However, under California case law, the analysis is different when the change order adds new work that must be performed **after** the extended contract completion date **has passed**. Requiring such new work is a totally voluntary act by the agency. The agency always has other options, *e.g.*, have the new work performed by someone else under a separate contract. Meanwhile, after the extended contract completion date, the contractor is into liquidated damages, and adding new work inevitably exacerbates the delay problems. Further, the addition of new work after the extended contract completion date, by definition, makes it impossible for the contractor to have met that completion date; the contractor now cannot possibly complete the contract until the new work is performed.

Thus, by issuing that change order, the agency (a) prevents the contractor from completing the contract by the already passed contract completion date, or (b) excuses the contractor's failure to complete before the new work is finished, foregoing liquidated damages through then, or (c) is estopped to assess liquidated damages prior to the date the new work is

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finished, or (d) waives any liquidated damages prior to the date the new work is finished. Three California cases have so held:

In *Howard J. White, Inc. v. Varian Associates* (1960) 178 CA2d 348, 2 CR 87, the contract, for a production facility at Stanford University, prescribed criteria for extending the contract completion date, including for change orders that caused delay. On June 18 and 27, 1957, at a time when the extended contract completion date was June 29, 1957, White was told to perform extensive extra work and that formal change orders would follow. The changes added work that Varian had originally planned to have others perform (178 CA2d 351). That extra work took 60 days and was not completed until September 3, 1957. Meanwhile, the formal change orders were issued on July 2 and July 30, and neither granted any time extension (178 CA2d 354). There apparently was no liquidated damages provision in the contract; Varian sought its actual delay damages suffered after the June 29 extended contract completion date. Held, at 178 CA2d 355-56:

Under the circumstances the trial court was justified in concluding that by its conduct Varian had made it impossible to complete and prevented White from completing the work by June 29.

\* \* \*

To restate the facts, the evidence supports the following conclusions: ... It would **clearly be unconscionable** under the circumstances to compel White to meet a completion date **within which the extra work** which he had thus undertaken in reliance on Varian's conduct **could not possibly be completed**.

"Waiver may be shown by conduct, and it may be the result of an act which, according to its natural import, is so inconsistent with the intent to enforce the right in question as to induce a reasonable belief that such right has been relinquished." [citations]

Since Varian's counterclaim depends entirely on its contention that White did not complete in time it follows that it must fail.

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In *Semas v. Bergmann* (1960) 178 CA2d 758, 761, 3 CR 277, the work overran the contract completion date by 69 days. Using the apportionment-of-delay approach, the trial court concluded that the contractor was responsible for 20 of the days and remitted liquidated damages for the other 49 days. The court of appeal reviewed the evidence supporting the judgment, found it sufficient and affirmed. With regard to three change orders, the third of which “provided for an enlargement of an upstairs office and reduction in area of an adjacent room,” the court held:

Defendants’ principal contentions concerning these change orders are ... That the change orders recited that there was to be no change in the contract time, and the contract itself provided that no extension of time would be granted. However, order 3 was dated February 1, which was after the contract date of completion. **It necessarily was a waiver of the time set for completion** [citation].” [boldface added]

In *Aetna Cas. & Surety Co. v. Board of Trustees* (1963) 223 CA2d 337, 35 CR 765, the school board assessed liquidated damages for a 125 day overrun of the October 3, 1958 extended contract completion date. The contractor’s surety sought to set them aside. The contractor was advised of changes on September 3 and September 29, 1958, but told not to perform the new work until it was approved by the State Department of Finance. Notice of the approval issued on January 6, 1959, and the contractor proceeded with the work. In other words, “as a result of the timing of change order 3B, the contractor would have been unable to complete the project by October 3, 1958, through no fault of his own” (223 CA2d 339). The court explained (223 CA2d 340):

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The facts indicated above clearly establish that while the contractor was behind in the overall job on October 3, 1958, the District, by its own conduct in processing the change orders, rendered performance impossible within the extended time agreed upon by the parties. The District contends that since there was no evidence that it caused any delay in the *ultimate completion of the entire project*, it should be allowed liquidated damages. We do not agree. The crucial date is that stipulated for completion.

The trial court had apportioned the liquidated damages, charging the contractor only with the overrun after January 6, 1959, when the change orders were approved by the Department of Finance. The appellate court criticized this apportionment (223 CA2d 340), because “a proper apportionment would necessarily have to allow the contractor a reasonable time beyond the change order notification on January 6, 1959, within which to complete the work called for.” But, ultimately, the appellate court applied the all-or-nothing approach to reject all liquidated damages.

These cases demonstrate that, by issuing change orders requiring extra work after the extended contract completion date, an agency can waive the contract completion date until that work is completed, can waive liquidated damages to the same date, can be estopped from enforcing liquidated damages to that date, or has prevented the contractor from completing by that date.

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