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Liquidated Damages and the Surety: Are They Defensible?

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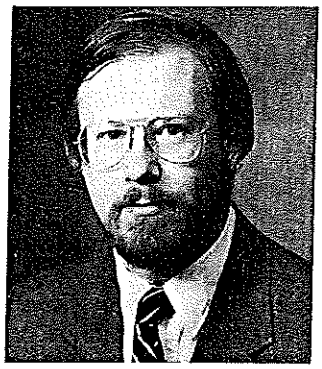

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Introduction

Almost every construction contract default and a consequent surety takeover involves not only excess costs to complete but also a claim for some type of consequential damages related to delays or other breaches when the work is completed. The owner's demand often is based upon a liquidated damages provision in the contract. When this occurs, the owner usually takes a simplistic position. It deducts the number of days in the original contract schedule from the actual number of days taken to complete the project, multiplies the difference by the contract amount of the liquidated damages and deducts the result from the amount of the remaining contract balances which would otherwise be paid to the surety.

There is no question that a performance bond surety may be liable for liquidated damages or actual damages resulting from delays in appropriate circumstances.[1] On the other hand, the mere fact that the bonded contractor or the completing surety has failed to complete the project within the original contract time frame, is not of itself a circumstance which permits a liquidated damages assessment against the surety. There are many legal doctrines which provide a surety—particularly a completing surety—with a wide range of defenses to an owner's automatic assessment of such damages. Given the usual complexity of a construction default, most projects should provide some facts which support the assertion of several of these defensive doctrines.

This paper will explore these principal defensive theories in general terms. As a cautionary foreword, however, it is useful to note that each case turns on its particular facts—particularly the language of the contract documents and the exchange of correspondence and other materials among the parties before the breach and default occurred. It also should be noted that while this article will discuss the general principles and cite authorities from various jurisdictions, the general legal principles themselves are not written in stone even within a particular jurisdiction. It is common to find case law within the same jurisdiction which is difficult or impossible to reconcile with other cases. It will also be seen that these general legal principles overlap to a considerable degree.

Definition and Purpose of Liquidated Damages

The term "liquidated damages" refers to a sum stipulated and agreed upon by the parties at the time of entering into a contract as the damages for injuries in the event of a breach.[2] The purpose of a liquidated damages clause is to establish—at the time the contract is entered into and in advance of any breach to which the liquidated damages provision relates—a certain, definite and *reasonable estimate* of the damages which would be incurred. When these conditions are satisfied, liquidated damages clauses are universally held to be enforceable. There are, however, many total or partial defenses to their enforceability and sometimes the right to assess liquidated damages may be voided altogether. The availability of any particular defense to a liquidated damages claim necessarily depends on the facts of each individual case. However, an analysis of the cases reveals three principal factual considerations which usually figure in the courts' decisions which have either upheld or abrogated a liquidated damages assessment:

1. whether the amount stipulated and actually assessed is grossly disproportionate to the actual damages resulting from the breach; and
2. whether the conduct of both contracting parties has contributed to the breach; and
3. the relative fault of the parties.

Although the most important application of liquidated damages involves contract delays, some contracts contain liquidated damages provisions that are related to performance standards apart from timeliness. Contracts may, therefore, contain varying liquidated damage provisions associated with different phases of the project, or related to performance standards and breaches other than delays. For example, in a design-build contract for a sewerage treatment plant utilizing an untried treatment

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process, it would not be unusual to find a liquidated damages provision linked to the quality of the effluent produced by the plant. While it is impossible to discuss all of the possible permutations here, it is worthwhile to note that the existence of one or even several liquidated damage clauses in a contract is not necessarily determinative of the total range of damages which may be recovered where a variety of breaches have occurred.

Other Damages

Liquidated damages clauses do not of themselves limit recovery for other breaches. Parties may agree that certain elements of damage which are difficult to estimate will be covered by a provision for liquidated damages, while other elements of damages will be ascertained in the usual manner.[3] Thus, an owner may be able to recover liquidated damages for delay, as well as actual damages associated with the repair or replacement of the contractor's defective work.[4] However, such situations generate considerable potential for overlapping or double recovery[5]—a result which may prove a fertile ground for defense and which generally will not be permitted by the courts.[6]

An owner cannot assess liquidated damages for delays in the contractor's performance which he has either caused or to which he has contributed.

Defensive Doctrines

Penalty

By far the most prevalent defensive doctrine in avoiding an assessment of liquidated damages is the concept of "penalty." A stipulated liquidated damage sum which is determined to be a "penalty" rather than "liquidated damages" is unenforceable.[7] The fact that the parties to a contract have agreed to a stipulated sum or even that they have described that sum as "liquidated damages" is not determinative, since these are merely facts to be considered among all the other relevant circumstances in the case.[8] The converse is also true; the use of the word "penalty" or "forfeiture" does not conclusively prove that the sum named was intended as a penalty[9]—although this too is a fact to be taken into consideration.[10] If the stipulated sum is deemed to be a penalty, it is not enforceable and the nondefaulting party is left to such actual damages as it can prove.[11]

It is difficult to lay down a general rule as to when a stipulation for damages in a construction contract will be deemed an unenforceable penalty. The cases considering this issue indicate that the following elements will be considered in determining the enforceability of contractual provisions for "liquidated damages":

1. the language used in the contract;
2. the surrounding circumstances known to the parties at the time the contract was executed;
3. the subject matter of the contract;
4. the intent of the parties;
5. whether the amount fixed is reasonable in the light of the anticipated or actual loss caused by the breach;
6. the difficulties of proof of loss.[12]

Some of these elements are more important than others. Indeed, when the cases are read carefully, some elements appear to be cited in the opinions principally to provide additional justification for the result, but without any meaningful analysis by the court as to how these elements bear upon that result and necessarily lead to the conclusion reached by the court. For example, the court will consider the language of the contract, but will generally not make this element controlling.[13]

The subject matter of the contract is dependent upon the facts of the particular case, and for that reason is not susceptible to any meaningful general analysis.

The element of intent often serves a useful purpose in defending a liquidated damages claim. When the provision has been inserted with the intent that the fixed amount be so large as to have a "threatening effect," the stipulated sum will likely be found to be a penalty.[14] Similar results have been reached where the provision was intended as security for actual damages,[15] or where it was clearly intended to apply whether or not the breach was a total or partial[16] or over a wide range of potential breaches, however minor their nature. In many situations—such as competitively bid public projects—there is no "meeting of the minds" between the parties regarding either the liquidated amount or the intent of the parties respecting the clause. As a consequence, other factors such as the amount of liquidated damages in comparison to the value of the contract, the size of the actual assessment compared to the nature of the breach and respective fault of the parties, and the difficulty of proving actual damages become far more critical in determining the validity of the provision.[17] It is far more likely that a liquidated damages provision in a public works contract situation will be found to be enforceable (especially by the owner).[18]

Generally speaking, the per diem amount set for liquidated damages is usually established by either the architect or the owner's consultant by *ad hoc* means without any meaningful attempt to analyze the probable damages which would occur as a consequence of the breach to which the provision applies. Although the circumstances known to the parties in setting the stipulated sum at the time the contract is executed are a factor to be taken

into consideration, it is difficult to find a case which actually addresses the factual question of whether the contract drafter actually attempted to objectively set a sum representing a reasonable estimate of the anticipated damages which would result from a prospective breach.

By contrast, in situations where the amount of actual damages could have been accurately forecast at the inception of the contract or can be accurately and easily calculated in the event of a breach—for example, the computation of lost rentals—the courts have invariably construed the provision as a penalty, particularly if the sum assessed is out of proportion to the actual loss.[19] While most of the cases so holding are fairly old, they provide a useful basis to avoid the assessment using a penalty defense theory in the modern privately financed project or in private projects which are financed through state or federal agencies, since the actual damages are usually fairly simple to determine.[20]

By far the most important element in determining whether the provision for a stipulated sum is a valid liquidated damages clause or an unenforceable penalty is whether the stipulated sum bears a reasonable relationship to any actual loss.[21] Although some courts have stated in *dicta* that the liquidated amount may be upheld even in situations where there are no actual damages,[22] it is difficult to find any case law which actually has applied that principle.[23] Despite such *dicta,* the unanimous view appears to be that the courts will not enforce an agreement which stipulates an amount out of proportion to the actual damage[24] or which is applied when in fact there is no damage.[25] Thus, where construction of a bridge was delayed, but construction of the bridge was finished before completion of the connecting roadway under another prime contract, an attempted assessment of liquidated damages was held to constitute an unenforceable penalty.[26]

On the other hand, where actual damages exceeding the liquidated damages result from delay in completing a commercial building, the owner cannot attack the liquidated damages provision as constituting a penalty and recover his actual damages.[27] The rationale for this apparently unbalanced result probably lies in the inconsistent bargaining power of the parties and the court's consideration of risks taken by the contractor in submitting its bid price which undoubtedly took the liquidated sum into account along with an overly ambitious schedule for construction.

There is a split of authority as to whether the determination of the nature of the stipulated sum is a question of law for the court or one of fact for the jury.[28] The majority modern view holds that the issue is a question of law for the court[29]—although resolution of the question may require a preliminary fact hearing.[30] If it is doubtful whether the provision is intended as a penalty or liquidated damages, the court will construe it as a penalty because the law favors simple indemnity and seeks to avoid the automatic assessment of stipulated sums which amount to a forfeiture.[31]

Burden of Proof Requirement

The party asserting a claim or defense regarding a liquidated damages provision has the burden of proving the underlying facts showing entitlement to the claim or the availability of the defense.[32] When the owner seeks liquidated damages or to uphold its unilateral enforcement of the provision (i.e., reduction of the contract balances), the modern majority view is that he has the burden of proving that he has strictly complied with all of the requirements for enforcement of the provision.[33] This consideration would appear to be of particular importance in deciding whether or not to litigate over an owner's assessment of the stipulated sum since meeting a particular burden of proof n a complex construction case is frequently difficult and sometimes impossible.

Historically, courts have refused to apportion delays where both the contractor and the owner contributed to delaying the work.

Mutual Responsibility

When delays or other contractual breaches occur on a construction project, the factual circumstances are invariably complex and frequently the cause of the delay or other breach may be attributable to both parties. This situation can provide a key factual basis for the surety to defend against the owner's assessment of liquidated damages or, at least, mitigate the erosion of the contract balances resulting from the assessment by reducing the time period over which such damages may be assessed. The general legal principle is simple: An owner cannot assess liquidated damages for delays in the contractor's performance which he has either caused or to which he has contributed.[34] The general rule is superficially simplistic. Like every other legal principle in this area, the outcome usually depends upon a careful analysis of the contract documents and the underlying facts. Some of the issues which may influence the result are as follows.

Changes

Performance of construction contracts commonly involves a number of changes. A negotiated lump sum change is universally viewed as an accord and satisfaction. Often such a change order is negotiated without an extension of time or a reservation of rights regarding a time extension at the completion of the project. However, even in these circumstances, the apparent majority view is that a liquidated damages provision cannot be

enforced without taking into account a reasonable time for the contractor to complete the increased work.[35] The right to assess liquidated damages may be abrogated altogether when the change is directed after the scheduled date for completion. *See* discussion on *waiver, infra.*

If the change has proceeded on a time and material basis, it will be unlikely that the contractor has been allowed to submit for costs or for time extensions other than for the labor and material or extensions directly related to the changed work. In such situations, the "ripple effect" caused by the change is frequently the subject of claims. Where these occur, by necessary analogy, the liquidated damages provision may be abated for the impact period of the change. More often than not, the duration of the impact period is considerably longer than the time actually taken in performing the change.[36] The assessment will be invalid for the period that the work was affected even if the duration of the actual work on the change is shorter.

It is impossible to derive a test that will determine in every case when the point of substantial completion has been reached.

However, if a negotiated extension of the time for completion has been granted because of a change and completion of the contract is delayed thereafter, the provision for liquidated damages will usually be enforced for the subsequent delay in the absence of other contributing causes for the delay.[37] Moreover, in some jurisdictions, liquidated damages may be awarded for delay periods caused by circumstances that would otherwise entitle the contractor to a time extension. This can happen if the contractor has failed to comply with the notice provisions of the contract documents giving notice of the delay, or if he has failed to reserve his rights to determine the total delay at some later point in time.[38] Construction contracts commonly contemplate that minor changes will be handled in the ordinary course of events. Hence, where the change is so minor as not to cause a delay, the liquidated damages provision may be enforceable for the entire period of delay in the absence of any other excusable causes for the time overrun.[39]

Apportionment

When delays occur on a construction project, the overall delay is frequently attributable to a variety of causes which are the subject of disputes, such as: owner or architect delays, contractor delays, and circumstances beyond the control of both parties (i.e., weather, strikes, etc.). Moreover, these contributory causes of the overall delay often overlap. In such circumstances, the extent of the delay which may be attributable to any cause is difficult to ascertain or to prove with any reliability; it is very rare that any single circumstance or combination of circumstances will actually cause a complete shutdown of the work at the project. Such situations generate a very complex set of facts; there are many divergent views as to whether the courts will apportion such delays or regard the right to assess liquidated damages as completely abrogated when any significant delay chargeable to the owner contributes to the overall delay.

Historically, courts have refused to apportion delays where both the contractor and the owner contributed to delaying the work.[40] Thus, the majority rule appears to be this: Where a contract contains a provision for liquidated damages for delay and delays are occasioned by mutual defaults, the provision will be deemed to be forfeited[41] *in the absence of a contract provision for apportionment.*[42] Some authorities go further and hold that the general rule applies notwithstanding the existence of express contract terms for apportionment of the delays.[43]

The contemporary approach, however, is to apportion the delays and enforce the provision against the contractor or its surety for the delays other than those caused by or attributable to the owner[44] or which may be excusable. But even in jurisdictions where the courts will allow apportionment, the result will depend upon the evidence presented. Whenever responsibility for a delay or its duration is impossible to discern from the evidence, or where both parties have contributed to the delay period and neither can establish (a) the extent to which the other is culpable or (b) that it is itself not culpable, neither can recover damages (liquidated or actual) from the other for the delay.[45] The burden of proof in such situations is often the critical determinant, since the burden of proof is on the party claiming such damages to prove that the damages were caused by the default of the party to be charged, and that the breach for which the damages are sought did not result from contributory acts of the claimant.[46] Conversely, if actual damages exceed the permissible liquidated damages which can be assessed under the contract, the owner cannot use its own culpability as a reason to abrogate the contract provision and seek actual damages.[47]

Abandonment of Contract

In some jurisdictions, it has been held that a liquidated damages clause applies only in the event that the contractor continues the work beyond the time in the contract and not when he entirely abandons the work.[48] Most of these cases, however, allow the owner to recover actual damages from the contractor (and by way of inference, from its surety) which can be significantly greater than the amount allowed under the clause.[49] Basically, the court will not let the clause stand in the way when the owner has sustained a greater measure of damages

and the contractor has willfully failed to perform — though where the owner insists on enforcing the clause against an abandoning contractor's surety, the courts will permit it. In such situations only an unwise surety would fail to arrange for completion of the contract.[50]

Substantial Completion

In virtually every jurisdiction, substantial completion of the work usually tolls the assessment of liquidated damages.[51] Substantial completion occurs on the date the work is *satisfactorily* completed to the extent that facilities *may* be occupied or are actually used for the purpose for which they are intended.[52] Generally, any attempt to assess liquidated damages after this date will result in the provision being construed as a penalty.[53]

While the rule is an easy one to state, the particular facts may present situations where it is unclear as to when substantial completion actually took place. The owner may not, in fact, occupy or use the structure until considerably after substantial completion has transpired—or conversely, out of necessity or in an effort to mitigate damages, the owner may occupy or use all or part of the structure, despite the fact that major components which interfere with the owner's use have not been completed due to the fault of the contractor. Thus, it is impossible to derive a test that will determine in every case when the point of substantial completion has been reached. Rather, this determination must be based upon the particular facts and the performance promised.

This last consideration may become a particularly acute one for the surety in a multiple prime contract situation, because the owner may be able to recover for both liquidated damages and the costs or damages which it expends to compensate the follow-on contractors whose schedules are disrupted.[54] On the other hand, courts have held that substantial completion occurs when the work is sufficiently complete to enable follow-on contractors to begin their work, despite the fact that the building is not sufficiently complete to be utilized for its intended purpose.[55]

Generally, the courts have intended to emphasize four factors in determining when substantial completion has occurred:[56]

1. whether the project is available for its intended use;
2. whether the owner has accepted and occupied the project or portions thereof despite the failure of full performance;[57]
3. percentage of completion at the end of the contract time period;
4. good faith effort of the contractor to perform fully.

Starting Date

Sometimes the starting date for contract performance may be a matter of confusion or dispute. Such a situation often arises on multiple prime contract public works projects. Many times, for reasons totally beyond the control of the contractor, the owner delays the notice to proceed or the letting of all of the contracts. Such circumstances distort all of the original contract schedules, the starting dates and the anticipated orderly progress of the interrelated work of the different prime contractors. When the owner eventually gets around to awarding all the contracts or issuing the notice to proceed, it is unusual for the originally contemplated schedules to be adjusted (as they should be). And it is often axiomatic that some of the work will be performed in bad weather or under conditions which were not foreseeable when the project was bid. In some instances, the owner may advance the date for scheduled completion for a period equal to the disputed delay between the award and the notice to proceed, but otherwise will refuse to recognize the impact of such facts as weather-related inefficiencies and the inability of certain primes to fully mobilize until all of the contracts are awarded and all notices to proceed are furnished. Such a situation can be very significant, since a dispute over the starting date from which to assess liquidated damages can be fatal to enforcement of the provision.[58]

Simply failing to terminate the contract after the completion date passes may not constitute a waiver in many jurisdictions.

Termination

Depending upon the language of the contract, it has been held that the right to terminate is an alternative to liquidated damages, and that the owner, having chosen to terminate, could not also claim liquidated damages.[59] However, if the owner terminates and completes, it is entitled to recover its excess costs and by necessary inference its actual damages.[60] The application of this rule is likely to be clearest in the circumstances where the termination has occurred before the contract completion date;[61] however, it has also been applied in a completing surety's favor when termination occurred after the scheduled completion date.[62]

It is important to note that the termination rule set forth above (essentially a federal rule) is not universally applied. The results may be different in state courts,[63] and even the federal rule may vary depending upon the contract language.[64] In short, the predictability of an "election to terminate" defense always turns upon a careful analysis of the case law in a particular jurisdiction and the contract language. If the contractor defaults instead of being terminated and the surety completes,

the surety may be liable for both the excess costs and liquidated damages in the absence of an express agreement to the contrary or a waiver of the liquidated damages in the takeover agreement.[65]

Waiver

Construction cases often present factual situations where an argument can be made that the owner has waived its right to assess liquidated damages. The application of the waiver defense is founded on common sense. As one noted authority has stated, "Either at law or in equity, a stipulation regarding time, though otherwise of the essence, may be waived. . . ." Such waiver need not be express, but may be inferred from the conduct of the parties:

> When a specific time is fixed for the performance of a contract and is of the essence of the contract and it is not performed by that time, but the parties proceed with the performance of it after that time, the right to suddenly insist upon a forfeiture for failure to perform within the specified time will be deemed to have been waived and the time for performance will be deemed to have been extended for a reasonable time.[66]

The clearest situations occur when the owner agrees to waive liquidated damages or fails to claim liquidated damages prior to final payment.[67] However, waiver has also been found in other circumstances, for example: where the owner failed to put the contractor on notice that it intended to enforce the provision; the owner allowed the contractor to complete after the scheduled date had passed;[68] or the owner continued to make progress payments to the contractor without a deduction for accrued liquidated damages.[69]

Such waiver need not be express, but may be inferred from the conduct of the parties. One clear, common example of waiver by conduct is the owner who not only induces continued performance after the scheduled completion date, but who actually directs or orders extra work after that time.[70] The cases which have discussed this circumstance seem to treat the right to assert liquidated damages as being abrogated altogether even if the change was ordered after a substantial delay had already transpired.

The "waiver" argument, however, is not always a reliable defense in the absence of a clear understanding with the owner. Simply failing to terminate the contract after the completion date passes may not constitute a waiver in many jurisdictions.[71] More importantly, in a case involving a federal contract and a completing surety, it was held that, *in the absence of a takeover agreement,* an intention to waive liquidated damages could not be proven, and the surety was held liable for liquidated damages under the terms of the original contract.[72]

Conclusion

While a performance bond surety may be liable for liquidated damages in appropriate circumstances, there are many defenses to their assessment and the right to make the assessment may be forfeited by the conduct of the party seeking to enforce the provision. In takeover or financing situations, whenever an assessment of liquidated damages is anticipated, the surety should ensure that appropriate actions are undertaken and defenses well documented at an early point in the course of the surety's investigation. ■

Footnotes

1. Ranger Constr. Co. v. Prince William County School Bd., 605 F.2d 1298 (4th Cir. 1979); Southern Roofing and Petroleum Co. v. Aetna Ins. Co., 293 F. Supp. 725 (E.D. Tenn. 1968); United States v. American Employers Ins. Co., 141 F. Supp. 281 (E.D. Pa. 1956); Pacific Employers Ins. Co. v. City of Berkeley, 158 Cal. App. 3d 145, 204 Cal. Rptr. 387 (1st Dist. 1984). A completing surety is not liable beyond the penal sum of its bond for liquidated damages, even though it might otherwise be deemed to have waived its bond limits when it sets out to complete a project. Aetna Casualty & Surety Co. v. Butte-Mead Sanitary Water Dist., 500 F. Supp. 193 (D.S.D. 1980).
2. United States v. J. C. Martin Lumber Co., 246 F.2d 58 (5th Cir. 1957).
3. Hathaway & Co. v. United States, 249 U.S. 460, 30 S. Ct. 346, 63 L. Ed. 707 (1919) (increased inspection costs); Hillsborough County Aviation Auth. v. Cove Bros. Contracting Co., 285 So. 2d 619 (Fla. App. 1973).
4. Spinella v. B-Neva, Inc., 94 Nev. 373, 580 P.2d 945 (1978) (defects).
5 *See, e.g., In re:* Plywood Co. of Pennsylvania, 425 F.2d 151 (3d Cir. 1970); Mac Namee v. Hermann, 53 F.2d 549 (D.C. Cir. 1931).
6. RESTATEMENT (SECOND) OF CONTRACTS, sec. 356 (1) (1979).
7. *See* 22 AM. JUR. 2D Damages sec. 212 et seq. *passim.*
8. United States v. Bethlehem Steel Co., 205 U.S. 105, 27 S. Ct. 450, 51 L. Ed. 2d 731 (1907); Mosler Safe Co. v. Maiden Lane Safe Deposit Co., 199 N.Y. 479, 93 N.E. 81 (1910).
9. American Surety Co. v. Hutchinson, 63 F.2d 536 (5th Cir. 1933).
10. Western Gas Constr. Co. v. Dowagiac Gas & Fuel Co., 146 Mich. 119, 109 N.W. 29 (1906); 5 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS, § 784 (3rd ed. 1961). The use of the term "forfeit," however, indicates that the parties regarded the sum as a penalty. Bauer v. Sawyer, 8 Ill. 2d 351, 134 N.E. 2d 329 (1954). The sum will be held to be such where there is nothing in the nature of the contract to show to the contrary. Hammaker v. Schleigh, 157 Md. 652, 147 A. 790 (Md. 1929); Wilkinson v. Colley, 164 Pa. 35 (1906).
11. Vandegrift v. Cowles Eng'g Co., 161 N.Y. 435, 55 N.E. 941 (1900).
12. *See* Utica Mutual Ins. Co. v. DiDonato, 187 N.J. Super. 30, 453 A.2d 559 (App. Div. 1982).
13. *See* cases cited in note 10, *supra*; Hennessy v. Metzgar, 152 Ill. 505, 38 N.E. 1058 (1894); Stewart v. Turner, 67 Pa. Super. 255 (1917) ("penalty").
14. In re: Plywood Co. of Pa., 425 F.2d 151 (3rd Cir. 1970); S.L. Rowland Constr. Co. v. Beall Pipe & Tank Corp., 14 Wash. App. 297, 540 P.2d 912 (1975); Ellis v. Roberts, 98 Pa. Super. 49 (1929).
15. Gregory v. Nelson, 147 Kan. 682, 78 P.2d 889 (1938); WILLISTON, *supra*, § 776.
16. United States v. J.C. Martin Lumber Co., *supra* note 2; Keck v. Bieber, 148 Pa. 645, 24 A. 170 (1892).
17. Oregon State Hwy. Comm'n v. De Long Corp., 495 P.2d 1215 (Ore. 1972).
18. The difficulty of measuring actual damages may be assumed in a public works case. *See* York v. York Railways Co., 229 Pa. 236, 78 A. 128 (1910). The assumption probably serves to explain the apparent greater willingness of the courts to uphold the provision in a public works contract situation. *See, e.g.,* Pacific Employees Ins. Co. v. City of Berkeley, 158 Cal. App. 3d 149, 204 Cal. Rptr. 387 (1st Dist. 1984) (citing public policy *favoring* liquidated damages provisions in public works contracts). *But see* B & L Painting Co., Inc. v. United Pacific Ins. Co., et al., 527 P.2d 554 (Mont. 1974), striking down an increase in a *per diem* liquidated damage amount as to one co-prime contractor where no increase was made as to other co-primes and the work of all of the co-primes was interrelated and interdependent.
19. J.C. Clements v. Schuyl R.R. Co., 132 Pa. 445, 19 A. 276 (1890); Westmount Country Club v. Kameny, 82 N.J. Super. 200, 197 A.2d 379 (App. Div. 1964); Franchise Realty Interstate Corp. v. State Col-

lege Shopping Center, Inc., 47 D&C 632 (Pa. C.P. Centre County 1963).

20. *See* Graham v. City of Lebanon, 240 Pa. 337, 87 A. 567 (1913).

21. It is also frequently possible in cases where the liquidated damages are out of proportion to the actual losses to establish facts which show that the assessment constitutes a double recovery. For example, a privately placed bond indenture is frequently issued to create a construction trust fund which is placed in a capitalized account. Interest earned on the account is used to provide debt service during the anticipated construction period. What happens in many cases, however, is that the stipulated sum is set in an amount equivalent to or higher than the anticipated debt service (or lost rentals) on the financing in the event of delay. Since this amount can be accurately established, a cogent argument can be made to have the provision voided since actual damages can be accurately established. Moreover, it is not uncommon to find situations where the delays have resulted in reduced requisitions which actually increase the amount of capitalized funds (and thus, the interest earned on those funds) remaining in the construction trust fund at any point in time. Thus, this extra interest is available to the owner to reduce its losses by providing additional funds to satisfy the debt service or to make up for lost rentals. Hence, insistence upon full assessment of the stipulated amount constitutes little more than a double recovery. When such situations exist, the surety should obtain and carefully examine all records which reflect anticipated cash flow projections, capitalized interest and actual capitalized earnings.

22. *See* United States v. LeRoy Dyal Co., 186 F.2d 460 (3rd Cir. 1950) (*dictum*).

23. Compare LeRoy Dyal, *supra* with Utica Mut. Ins. Co., *supra* note 12. *See also* Dorrance v. Lehigh Valley Coal Co., 13 F. Supp. 73 (M.D. Pa. 1936), aff'd 83 F.2d 334 (3rd Cir. 1937), and Langoma Lumber Corp. v. United States, 140 F. Supp. 460 (E.D. Pa. 1955).

24. Loggins Constr. Co. v. Austin State Univ., 543 S.W. 2d 682 (Tex. Civ. App. 1976).

25. *See* cases cited in note 23 *supra*; Priebe & Sons, Inc. v. United States, 332 U.S. 407, 68 S. Ct. 123, 92 L. Ed. 32 (1947); United States v. United Eng'g & Contracting Co., 234 U.S. 236, 34 S. Ct. 843, 58 L. Ed. 1294 (1914); Rispin v. Midnight Oil Co., 291 F. 481 (9th Cir. 1923).

26. Massman Constr. Co. v. City Council of Greenville, Miss., 147 F.2d 925 (5th Cir. 1945).

27. Monsen Eng'g Co. v. Tami-Githens Inc., 219 N.J. Super. 241, 530 A.2d 313 (App. Div. 1978); Brower Co. v. Garrison, 2 Wash. App. 424, 468 P.2d 469 (Wash. App. 1970); *but see* P&C Thompson Bros. Constr. Co. v. Rowe, 433 So. 2d 1388 (Fla. App. 1983). *See also* Industrial Indemnity Co. v. Wick Constr. Co., 680 P.2d 1100 (Alaska 1984), in which a general contractor sought actual damages from a subcontractor and its surety. On appeal, the surety successfully pointed out that the subcontract contained a "conduit" clause incorporating the general contract, which included a liquidated damages clause. The surety successfully argued that this liquidated damage clause also applied to the general contractor's claims against the subcontractor, thereby resulting in a greatly decreased award to the general contractor. This case is a stern reminder that sureties may be confronted with situations where they would *prefer* to be bound by a liquidated damages clause.

28. *Compare e.g. Mosler Safe Co., supra* note 8, with Laughlin v. Bathalden, Inc., 191 Pa. Super. 611, 159 A.2d 26 (1960).

29. Ruckelshaus v. Broward County School Board, 494 F.2d 1164 (5th Cir. 1974).

30. *See Utica Mutual Ins., supra* note 12.

31. Monmouth Park Assoc. v. Wallis Iron Works, 55 N.J.L. 132, 26 A. 140 (E&A 1892); Westmount Country Club v. Kameny, 82 N.J. Super. 200, 197 A.2d 379 (App. Div. 1964). In some jurisdictions, a number of older cases established the presumption that a stipulated sum for breach named by the parties to a contract is a penalty rather than liquidated damages. *See, e.g.*, Keck v. Bieber, 148 Pa. 645, 24 A. 170 (1982). This is no longer the modern majority view, but it may be of importance in jurisdictions which have not reconsidered this aspect of the law for some time.

32. Hughes Brothers v. United States, 134 F. Supp. 471 (Ct. Cl. 1955). A surety defending against a liquidated damage claim on the ground that the contract was substantially completed on the scheduled completion date bears the burden of proof on that issue. Aetna Casualty & Surety Co. v. Butte Mead Sanitary Water Dist., 500 F. Supp. 193 (D.S.D. 1980).

33. Kent v. United States, 343 F.2d 349 (2d Cir. 1965); Wunderlich Contr. Co. v. United States, 351 F.2d 956 (Ct. Cl. 1965). *Utica Mutual Ins., supra* note 12; General Ins. Co. of America v. Commerce Hyatt House, 5 Cal. App. 3d 460, 85 Cal. Rptr. 317 (1970). One recent New Jersey case, while purporting to buck this modern trend, as a practical matter follows it. Monsen Eng'g Co. v. Tami-Githen Inc., 219 N.J. Super. 241, 530 A.2d 313 (App. Div. 1987). The *Monsen* court disagreed with *Utica Mutual, supra* note 12, holding that the burden of proving entitlement to relief from a liquidated damage clause was on the defendant rather than on the claimant. Under *Utica Mutual* the claimant had to show that its own actions did not contribute to the delay for which it was assessing liquidated damages. 219 N.J. Super. at 249, 530 A.2d at 317. *Monsen* recognizes, however, that a claimant still must prove the existence of a *valid* liquidated damages clause, i.e., that it is not a "penalty" and the damages sought are reasonable — not dissimilar from the *Utica Mutual* holding. The cases are also factually reconcilable: in *Utica Mutual* defendant had introduced proofs showing that the claimant had contributed to the delay; in *Monsen* it had not. Thus, the cases are reconcilable on the basis that the burden of proof on apportionment of the delay shifts to the claimant once there is some proof that the claimant's conduct contributed to the delay. *See* discussion on Mutual Responsibility and Apportionment, *infra*.

34. United States v. Kanter, 137 F.2d 828 (7th Cir. 1943); Aetna Casualty and Surety Co. v. Bd. of Trustees of Rincon Val. Union Sch. Dist., 223 Cal. App. 2d 337, 35 Cal. Rptr. 765 (1963); Texter v. Wachs, 73 Pa. Super. 19 (1919); *Utica Mutual Ins., supra* note 12.

35. Coal & Iron R. Co. v. Rehead, 204 F. 859 (4th Cir. 1913). Parish Mfg. Corp. v. Martin-Parry Corp., 285 Pa. 131, 131 A. 710 (1926).

36. *See* Clarke Baridon, Inc. v. Merritt-Chapman & Scott Corp., 311 F.2d 389 (4th Cir. 1962); Wallace Process Piping Co. v. Martin-Marietta Corp., 251 F. Supp. 411 (E.D. Va. 1965).

37. *Cf.* Rose v. United States, 129 F. Supp 954 (Ct. Cl. 1955).

38. Bloomfield Reorganized School Dist. v. Stites, 336 S.W. 2d 95 (Mo. 1960); Austin-Griffith, Inc. v. Goldberg, 224 S.C. 372, 79 S.E. 2d 447 (1953).

39. Rose v. United States, *supra* note 37; *cf.* American Eng'g Co. v. United States, 24 F. Supp. 449 (E.D. Pa. 1938).

40. United States v. United Eng'g and Contractor Co., 234 U.S. 236, 34 S. Ct. 843, 58 L. Ed. 1294 (1914); Caldwall & Drake v. Schmulbach, 175 F. 429 (4th Cir. 1909); Levering & Garrigues Co., v. United States, 73 Ct. Cl. 566 (1932); Turzillo Contracting Co. v. Messer & Sons, Inc., 234 Ohio App. 2d 179, 52 Ohio Op. 2d 263, 261 N.E. 2d 675 (1969); State v. Parson Constr., 456 P.2d 762 (Id. 1969).

41. *See* Parson Constr., *supra*.

42. *Compare United Eng'g and Contracting Co., supra* with Robinson v. United States, 261 U.S. 486, 43 S. Ct. 420, 67 L.Ed. 760 (1922). Some of this case law inconsistently recognizes a residual right of the owner to prove a case of actual damages for an apportionable period of the delay. *See Levering & Garrigues Co., supra* note 40 at 578.

43. *Caldwell & Drake, supra* note 40; Jones Constr. Co. v. Greenbriar Shopping Center, 332 F. Supp. 1336 (N.D. Ga. 1971).

44. E.C. Ernst, Inc. v. Manhattan Constr. Co., 551 F.2d 1026 (5th Cir. 1977); Concrete Materials, Inc. v. Smith & Plaster Co., 127 Ga. 813, 195 S.E. 2d 219 (1973); Buckley & Co., Inc. v. State of New Jersey, 140 N.J. Super. 289, 356 A.2d 56 (Law Div. 1975); WILLISTON, *supra* note 10, sec. 789. The court in Aetna Casualty & Surety Co. v. Butte Mead Sanitary Water Dist., 500 F. Supp. 193 (D.S.D. 1980) found that the completing surety as well as the owner and the contractor contributed to the delay in completion, requiring apportionment of the delay among all three parties. The court followed recent case law favoring such apportionment despite the difficulty of the process, noting that simply because the owner contributed to the delay in the completion of the project, it should not be barred totally from recovering liquidated damages.

45. Buckley & Co., *supra* note 44; *see also* Lichter v. Mellon-Stuart Co., 305 F.2d 216 (3rd Cir. 1962).

46. Pathman Constr. Co. v. Hi-Way Elec. Co., 65 Ill. App. 3d 480, 382 N.E. 2d 453 (Ill. App. 1978); *Utica Mut. Ins., supra* note 12.

47. Mars Assocs. Inc. v. Facilities Dev. Corp., 124 A.D. 2d 291, 508 N.Y.S. 2d 87 (1986); X.L.O. Concrete Corp. v. Brady & Co., 104 A.D. 2d 181, 482 N.Y.S. 2d 476 (1984), *aff'd*, 66 N.Y. 2d 970, 498 N.Y.S. 2d 799, 489 N.E. 2d 768 (N.Y. 1985).

48. Six Companies v. Highway Dist., 311 U.S. 180, 61 S.Ct. 186, 85 L.Ed. 114 (1940); Fidelity & Deposit Co. of Maryland v. Robertson, 136 Ala. 379, 34 So. 933 (1903); City of Rainier v. Masters, 79 Or. 534, 154 P. 426 (1916); *contra*, Pacific Employers Ins. Co. v. City of Berkeley, 158 Cal. App. 3d 145, 204 Cal. Rptr. 387 (1st Dist. 1984).

49. *Cf.* Continental Realty Corp v. Andrew J. Crevolin Co., 380 F. Supp. 246 (S.D. W. Va. 1974); *but see* Southern Pacific Co. v. Globe

Indemnity Co., 21 F.2d 288 (2d Cir. 1927).

50. *See* discussion and authorities cited in the paper *The Surety's Do-Nothing Option — Is It Safe?*, Fidelity and Surety Law Committee, Tort and Insurance Practice Section, ABA (1981). *See also Pacific Employers Ins. Co., supra* note 48, enforcing a liquidated damages clause in a public works contract against the surety of an abandoning contractor. The court relied upon Cal. Pub. Cont. Code § 10226 (1988) and Cal. Gov't. Code § 53069.85, which expressly provide for liquidated damage clauses in public contracts. Thus, the rationale for enforcing this provision against the surety was considered to be a matter of state public policy which avoided the necessity of considering any of the surety's other arguments. *Pacific Employers Ins. Co., supra* note 48, 158 Cal. App. 3d at 152 n. 3, 204 Cal. Rptr. at 392 n. 3.

51. Heinkel v. City of Corvallis, 13 Or. App. 375, 510 P.2d 579 (1973); *but see* London Guaranty & Accident Co. v. Las Lormitos School Dist., 191 Cal. App. 2d 423, 12 Cal. Rptr. 598 (1961) (actual total completion required by contract).

52. *Pathman Constr. Co.*, ASBCA 16781, 74-2 B.C.A. (CCH) ¶ 10785; *W&J Constr. Co., Inc.*, ASBCA Nos. 12919, 13050, 69-2 B.C.A. (CCH) ¶ 7798; AIA Doc. A.201 Art. 8 (1976 ed.). A.I.A. Doc. A. 201 Art.9.8.1 (1987 Ed.). *See also* United States f/u/b Control Systems Inc. v. Arundel Corp., 814 F.2d 193 (5th Cir. 1987) (no liquidated damages after date project was "functionally operational"; despite additional delays incurred in installing electronic control center, project could become "functionally operational" without it). One recent decision, *In re Rivera Constr. Co., Inc.*, ASBCA 30207, 88-2 B.C.A. ¶ 20,750 holds that the owner's right to assess liquidated damages terminates when a project *might* have been beneficially occupied despite major incomplete work and punch list items as opposed to when the owner actually occupied the project. This case suggests that the owner may have a duty to occupy an incomplete project if reasonably possible in order to mitigate damages. However, the precise holding of the case is unclear from its facts since the owner eventually occupied the incomplete project at a later point.

53. United States v. Kanter, *supra* note 34; *S.L. Rowland Constr. Co, supra.*

54. *See* Bethlehem Steel Co. v. City of Chicago, 234 F. Supp. 726 (N.D. Ill. 1964); Associated Engineers & Contr., Inc. v. State, 58 Haw. 187, 567 P.2d 397 (1977).

55. *Cf. Electrical Enterprises, Inc.*, 74-1 B.C.A. (CCH) ¶ 10,400.

56. *See* Formigli Corp. v. Fox, 348 F. Supp 629 (E.D. Pa. 1972); Lowy v. United Pacific Ins. Co., 67 Cal. 2d 87, 60 Cal. Rptr. 225, 429 P.2d 577 (1967).

57. The refusal of an owner to accept and occupy the building is not determinative of whether substantial completion has or has not been reached. *Cf.* United States f/u/b Control Systems Inc. v. Arundel Corp., 814 F.2d 193 (5th Cir. 1987); *Rivera Constr. Co., supra.*

58. Pennsylvania v. Mosites Constr. Co., 43 Pa. Cmmwlth. 266, 402 A.2d 303 (1979); Camden Iron Works v. United States, 51 Ct. Cl. 9 (1915).

59. United States v. Cunningham, 125 F.2d 28 (D.C. Cir. 1941); The Fidelity & Casualty Co. of New York v. United States, 81 Ct. Cl. 495 (1935); *but see* Continental Casualty Co. v. United States, 113 F.2d 284 (5th Cir. 1940) (This case has apparently been overruled *sub silentio*).

60. *Id.*

61. Transamerica Ins. Co. v. McKeesport Housing Auth., 309 F. Supp. 1321 (W.D. Pa. 1970).

62. *Cunningham, supra* note 59; United States v. American Surety Co., 322 U.S. 96, 64 S.Ct. 866, 88 L.Ed. 1158 (1944); United States v. Maryland Casualty Co., 25 F. Supp. 778 (S.D. Mass. 1938); Maryland Casualty Co. v. United States, 93 Ct. Cl. 247 (1941); Firemen's Fund Indemnity Co. v. United States, 93 Ct. Cl. 138 (1941); *see also* Fidelity & Casualty Co. v. United States, 81 Ct. Cl. 495 (1935); American Employer's Ins. Co. v. United States, 91 Ct. Cl. 231 (1940).

63. *See e.g.*, Emmaus Municipal Auth. v. Eltz, 31 Leh. L.J. 216 (Pa. C.P. Lehigh Co., 1965).

64. *See* United States v. American Employers Ins. Co., 141 F. Supp. 281 (E.D. Pa. 1956); *The Buckeye Union Casualty Co.*, ASBCA No. 6770, 61-2 B.C.A. ¶ 3215.

65. Hartford Accident and Indemnity Co. v. United States, 127 F. Supp. 565 (Ct. Cl. 1955); *Buckeye Union Casualty Co., supra* note 64.

66. WILLISTON, *supra* note 10, sec. 856.

67. Maryland Steel Co. of Baltimore v. United States, 235 U.S. 451, 35 S.Ct. 190, 59 L. Ed. 312 (1915); *Chapter Corp.*, ASBCA 17259, 75-1 B.C.A. (CCH) ¶ 11236.

68. Parish Mfg. Corp. v. Martin-Perry Corp., 285 Pa. 131, 131 A. 710 (1926).

An unusual application of this principle was presented in B & L Painting Co., Inc. v. United Pacific Ins. Co., et al., 527 P.2d 554 (Mont. 1974). Three co-prime contractors performed work for a school board; the school board granted an extension of time to all of the contractors, but increased the liquidated damage provision in one contractor's agreement from $50 per day to $500 per day. When the contract was completed 61 days late, the one contractor was assessed $30,500 in liquidated damages while the others were only assessed $3,050. The court held that the increase in liquidated damages as to only one of the co-primes was improper given the fact that all co-primes had contract obligations which were interrelated and interdependent. The court held it fundamentally unfair that one contractor would be charged an inordinate amount of liquidated damages where at least part of the delay was attributable to another co-prime over whom the first co-prime had no control.

The trial court had also held that the change order extending time and increasing liquidated damages was totally invalid, thus voiding the time extension on the ground that no notice of the changes were given to any subcontractor or surety, thereby restoring the original completion date. The appellate court overruled this holding on the ground that this ruling did not take into account the interdependency of the three prime contractors. The extension of time was also upheld on an estoppel theory. All three co-prime contractors were held to the lower liquidated damage amount, the assessment of which could not commence until the extended completion date.

69. Coryell v. Dubois Borough, 226 Pa. 103, 75 A. 25 (1909); *Dillon Constr. Inc.*, Eng. B.C.A. (CCH) PCC-36, 81-2 B.C.A. ¶ 5416.

70. Rochewell v. Mountain View Elec. Assoc., Inc., 521 P.2d 1272 (Colo. 1974); United States v. Gillioz & Kerns Constr. Co., 140 F.2d 792 (8th Cir. 1944); Tanes Constr. Co. v. Greenbriar Shopping Center, 332 F. Supp. 1336 (N.D. Ga. 1971); Universal Builders, Inc. v. Moon Motor Lodge, Inc., 430 Pa. 550, 244 A.2d 10 (1968).

71. Alpin Constr. Co. v. Water Works Board of Birmingham, 377 So. 2d 954 (Ala. 1959).

72. *General Constr. Co. of America*, B.C.A. 1178-2, 79-1 B.C.A. (CCH) ¶ 137700.