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CONSTRUCTION ALERT

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Understanding the enforceability of your liquidated-damages clause

On Feb. 24, 2016, the Ohio Supreme Court in the case of *Piketon v. Boone Coleman Constr. Inc.*, Slip Opinion No. 2016-Ohio-628, reaffirmed the enforceability of liquidated damages and the application of such contract provisions in public-works contracts. *Boone Coleman* provided a road map for owners and contractors to assure that the agreed liquidated-damages provision will be reasonable and enforceable.

In *Boone Coleman*, the parties entered into a contract where the City of Piketon, as project owner, agreed to pay contractor Boone Coleman $683,300 to complete a public improvement project. The contract expressly provided that the time for completing the project was "of the essence," which means that a material breach occurs when the work is not completed by the contractor within a specified time. A liquidated-damages provision made clear that Boone Coleman was to pay $700 to the city for each day after the specified completion date that the contract was not substantially completed.

Boone Coleman completed the project 397 days after the contract completion date. As result of the liquidated-damages provision contained in its contract, Boone Coleman owed $277,900 in damages to the City of Piketon, or roughly 40 percent of the contract price. As a result, Piketon refused to pay the contract balance of $147,477 to Boone Coleman.

Boone Coleman sued the City of Piketon, challenging the liquidated-damages provision as punitive and unenforceable. The trial court held in favor of the City of Piketon and awarded it damages of $277,900. When Boone Coleman appealed the decision, the Fourth Appellate Court reversed, concluding that when viewing the contract as a whole in its application, the amount of damages was so manifestly unreasonable and disproportionate that it was plainly unrealistic and inequitable. Thus, the Appellate Court decided that the liquidated-damages provision in the Boone Coleman contract amounted to an unenforceable penalty. The City of Piketon appealed this decision to the Supreme Court of Ohio.

The Supreme Court reversed the Appellate Court and effectively reinstated the trial court decision in favor of the City of Piketon. The Supreme Court's decision outlined several factors to consider in determining whether a liquidated-damages provision is enforceable. These factors include:

1. The sophistication of the contracting parties.
2. Whether both sides were represented by counsel.
3. Was the contract the result of an arms-length negotiation without overreaching?
4. Were actual damages difficult to quantify in the event of a breach?
5. Is the liquidated-damages provision a per diem measure rather than a lump sum?

After reviewing the factors, the Supreme Court concluded that the Appellate Court erred in focusing on the reasonableness of the total amount of liquidated damages in application, rather than the reasonableness of the per diem amount in the contract term. Thus, the Supreme Court held that a proper analysis examines whether it was reasonable to assess $700 per day in liquidated damages for each day that the contract was not completed—rather than looking at the aggregate sum of $277,900.

Although there are no guaranties that a court will always find a stated per diem damage amount enforceable, the Court looked favorably upon the schedule utilized by the Ohio Department of Transportation. Thus, the ODOT per diem liquidated damages standard values, stated below, would most likely be upheld as enforceable when challenged going forward:

Contract amount range	Per diem charge
$0 to $500,000	$500
$500,000 to $2 million	$1,000
$2 million to $10 million	$1,500
$10 million to $50 million	$2,600
Over $50 million	$3,200

On April 15, 2016, after considering the Supreme Court's ruling, the Pike County Appellate Court affirmed the trial court's decision and entered judgment for the City of Piketon in the sum of $277,900, representing 100 percent of the liquidated damages initially agreed upon.

Conclusion

The critical takeaways from *Boone Coleman* were that (1) the contracted for liquidated-damages provision must be evaluated from the standpoint of the parties at the time of the contract, rather than after the material breach has occurred, and (2) the parties must contract for a reasonable per diem amount.

As a result, contractors can anticipate that every construction contract could include a liquidated-damages provision modeled after this decision. Thus, it is important to know the enforceability of the liquidated-damages provision before signing any contract. Only then can a contractor confidently understand its exposure to an unexpected project expense when failing to complete on time.

For more information please contact Walter Reynolds, Ryan Sherman, Tom Nocar or any member of Porter Wright's Construction Litigation Practice Group.