

USE OF LIQUIDATED DAMAGES IN GOVERNMENT CONTRACTS

Other than construction contracts, the use of liquidated damages in government contracts has been infrequent. Regulatory guidance in FAR Subpart 11.5 provides general standards for use of a liquidated damages provision. While the guidance does not limit use of such provisions to construction contracts, the regulations provide specifics only in the construction area (FAR11.503(b)). Additionally, the DFARS implementation appears to provide no additional guidance other than to require the use of a liquidated damages provision in most construction contracts over \$500,000.

Buying activities are frequently frustrated by the late delivery of supplies, particularly spare and repair parts, where the typical government remedy is the default clause. The consequences to the government of late delivery are frequently difficult to establish in terms of the amount of damages. The FAR guidance at 11.502(b) is often cited by contracting and legal personnel as a basis for not including a liquidated damages provision in contracts.

The rate of liquidated damages used must be reasonable and considered on a case-by-case basis since liquidated damages fixed without any reference to probable actual damages **may** be held to be a penalty, and therefore unenforceable. (emphasis added).

In a fairly recent decision by the United States Court of Appeals, Federal Circuit, (DJ Manufacturing Corporation v. U.S., 86 F.3d 1130 (Fed. Cir. 1996), the Court recognized that while state courts may be hostile to liquidated damages clauses, the federal law “does not look with disfavor upon liquidated damages provisions in contracts.” While the practitioner should recognize that this case involved a contract for supplies (field packs) to support Desert Storm Troops (thus, presumably lending some degree of credibility to the “importance” of the delivery schedule), the contractor raised several issues which have often been the basis for a decision not to include such a provision in supply contracts.

The contractor argued that the rate used to calculate damages was a standard rate used in numerous solicitations; that the amount of liquidated damages bore no relationship to actual damages; and, that the government failed to show that the amount of liquidated damages was reasonable. The Court, granting the government’s motion for summary judgment, dismissed the contractor’s complaint.

The Court stated that the contractor, rather than the government, has the burden of proof in challenging the enforceability (reasonableness) of a liquidated damages provision. The Court provided a useful discussion of numerous federal court decisions in this area. The Court cites an opinion of the noted jurist, Learned Hand, for the proposition that “courts

should encourage [such agreements] to the utmost instead of being disposed to lean against them.”

Where the government determines that liquidated damages are a useful tool to both compensate the government for late delivery as well as a “spur” to performance, contracting personnel should not be unduly constrained regarding the use of a liquidated damages clause. It is suggested that the federal case law in this area be examined and that the acquisition community consider a greater use of liquidated damages provisions in contracts.