

Office Memorandum • UNITED STATES GOVERNMENT

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TO : Files

FROM : Office of the General Counsel

SUBJECT: Limitation of Damages

DATE: 18 October 1948

STATINTL

1. This contract provides for the installation, and maintenance and operation of a burglar-alarm system. This contract contains a clause limiting the liability of the contractor to the Government for each breach. The liquidated damages are nominal (\$50.00) and are proposed on the basis that it would be "impractical and extremely difficult to fix the actual damages". In this regard, it is assumed that the contents of the vault protected will consist of almost, if not, entirely classified papers which are not readily susceptible to monetary valuation.

2. The law appears to be well settled that the parties to a contract may agree on liquidated damages for any breach of the contract when the material or services to be provided under the contract cannot be readily obtained on the open market, and damages would be difficult to determine. The Supreme Court has stated (*San Printing and Publishing Association v. Moore*, 183 U.S. 642) that:

"The decisions of this court on the doctrine of liquidated damages and penalty lend no support to the contention that parties may not bona fide, in a case where the damages are of an uncertain nature, estimate and agree upon the measure of damages which may be sustained from the breach of an agreement. On the contrary, this court has consistently maintained the principle that the intention of the parties is to be arrived at by the proper construction of the agreement made between them, and that whether a particular stipulation to pay a sum of money is to be treated as a penalty, or as an agreed ascertainment of damages; is to be determined by the contract, fairly construed, it being the duty of the court always, where the damages are uncertain and have been liquidated by an agreement, to enforce the contract."

3. On the other hand, if the stipulation for liquidated damage is, on the face of the contract, disproportionate to possible actual damages, then the sum will most probably be construed as a penalty and enforced only to the extent of actual damages sustained. In passing, it is noted that proper liquidated damages do not have to be proven; it is sufficient to plead the breach of contract.

4. In reviewing the statutes and opinions, there does not appear to be any restriction of the Government's right to agree to liquidate damages. When 'Time of Delivery' is of the essence or services or material cannot be readily obtained in the open market, an appropriate liquidated damages clause can be properly included in the contract. Generally, liquidated damages should not be permitted to exceed the contract price, although this usually applies to situations where supplies or commodities can be readily obtained, and, in which liquidated damages should not have been stipulated at all. The converse is illustrated in the situation on which the Comptroller commented in 16 Comp. Gen. 344. In that case, damages were stipulated for delays in delivery of two items of material not readily obtainable in the open market. Damages amounted to \$800.00 for \$105.00 worth of supplies, and the Comptroller stated that although the clause was appropriate, there was no apparent relationship between the agreed sum and the potential injury. For the absence of a showing of actual damage resulting from the delay in delivery, the provision was treated in the nature of a penalty and not recognized. It should be noted that a contributing factor to this conclusion was the fact that the stipulated damages applied equally to two items and failed to distinguish a suitable measure of damages. ~~proportionate to the injury.~~

5. The opinions of the Comptroller have been directed at contracts in which payment of stipulated damages have worked a hardship on the Contractor rather than the Government. The clause in the contract under consideration is governed by the general rules outlined above, but it also raises the question of whether there is any limitation on the contracting officer's authority to limit the Government's potential right to claim damages. Since the services to be provided cannot be readily (indeed, cannot be satisfactorily) obtained from any other contractor, a liquidated damages clause is appropriate. Since it is assumed that the contents of the protected vault do not have an intrinsic value in money, the amount indicated in the clause may be accepted as appropriate. If at any time there is a loss of property which is susceptible to accurate evaluation, then the stipulated amount might be considered so disproportionate as to permit an assessment of actual damage.

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