

WAIVING CONSEQUENTIAL DAMAGES

What are you Getting? What are you Giving Up?

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Almost all standard construction industry contracts contain some form of waiver of consequential damages. Owners, contractors, subcontractors, suppliers and design professionals all include consequential damages waivers in their contracts, hoping to minimize the risk of unexpected or excessive damage awards in the event of litigation. In doing so, most parties view these clauses as mere boilerplate – assuming that the term “consequential damages” describes a fairly narrow and well-defined set of potential damage items that are out of the ordinary in a typical construction dispute.

Unfortunately, that may be far from true.

CONSEQUENTIAL DAMAGES WAIVER PROVISIONS

Waivers can take various forms, ranging from a broad mutual waiver of consequential damages, to a waiver of specifically listed damages for each party. Perhaps the most-recognized consequential damages waiver is the American Institute of Architects (AIA) Document A201-2007, ¶15.16 “Claims for Consequential Damages,” which provides that the Owner¹ and Contractor² “waive Claims against each other for consequential damages arising out of or relating to this Contract,” and then lists specific types of damages the Owner and Contractor each agree to waive.

The Florida Department of Transportation (FDOT) also addresses the recovery of consequential damages. Article 5-12.10 “Non-Recoverable Items” of the *2016 Standard Specifications for Road and Bridge Construction* provides in pertinent part that “the Department will not have liability for ... Consequential damages, including, but not limited to, loss of bonding capacity, loss of bidding opportunities, loss of credit standing, cost of financing, interest paid, loss of other work or insolvency (...).”

Unlike the AIA provision, the FDOT specification is unilateral, and only the contractor is precluded from recovering consequential damages against the Department. While at first glance this section appears to prohibit recovery of all consequential damages, however, other provisions of the specifications specifically identify some kinds of consequential damages are available under certain circumstances, such as material cost escalation or increased home office overhead.

WHAT ARE CONSEQUENTIAL DAMAGES?

For more than 150 years, courts have recognized two main categories of damages that can arise from a breach of contract: direct damages and consequential damages.³ According to Black’s Law Dictionary, direct damages are those which “follow from the type of wrong complained of.”⁴ Conversely, consequential damages are defined as

"losses that do not flow directly and immediately from an injurious act, but that result indirectly from the act."⁵ In short, consequential damages are anything other than direct damages. If this distinction appears confusing, you are not alone.

WHAT IS THE CONFUSION?

Consequential damages waivers are common in construction contracts and are enforceable as long as the waiver is clear and unambiguous.⁶ But the real problem is that, although seemingly everyone thinks that waivers of consequential damages are a good idea, no one can agree on what consequential damages actually are.

That is not to say that there is no general agreement as to whether some common damage items should be classified as either direct or consequential. Examples of direct damages include the brick-and-mortar costs for labor, equipment and materials incurred by an owner to complete a project following the contractor's default or wrongful abandonment of a project, or the costs incurred by a contractor for additional labor, equipment and materials required due to design defects or differing site conditions. Similarly, some well-recognized examples of consequential damages owners might incur include loss of profits from operations, loss of business opportunities, forfeited deposits, penalties or loss of tax advantages. On the contractor's side, examples include loss of professional reputation, impaired bonding capacity, lost bidding opportunities, lost profits on other projects or insolvency and bankruptcy.

Yet as one court observed, "(de)spite the vast number of cases purporting to define 'consequential damages' by repeating the same time-honored but general

definitions and distinctions between consequential and direct damages, the meaning remains elusive ... (F)ew transactional lawyers can define 'consequential' damages accurately and many misconstrue the impact a waiver of such damages may have ... (N)o one knows what consequential damages are or may be, at least not with predictability or uniformity."⁷ Another court summed up the legal distinction between consequential damages and other types of damages by saying it "resembles the kind of 'ambiguous law' that eludes analysis."⁸ Unfortunately, none of this is very helpful to those who are drafting, negotiating and entering into multimillion-dollar contracts that contain waivers of consequential damages.

Problems arise when a court interprets a consequential damages waiver more broadly than one (or both) of the parties intended. For example, most would be surprised to learn that, unless there are other provisions in the contract that specifically allow them, delay damages – including extended home office overhead – are caught up by a typical waiver of consequential damages. Nevertheless, the Florida Supreme Court has held that an owner's delay damages on a construction project are consequential damages,⁹ and the United States Supreme Court has likewise held that a contractor's delay damages are considered consequential damages.¹⁰ In another case decided under Florida law, the court went even further and found that a subcontractor's increased labor and material costs from the general contractor's schedule and coordination problems were consequential damages.¹¹

The lesson to be learned from these cases and others like them is that a contractor may not know how a judge or arbitrator will interpret a waiver of consequential damages



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until it is too late. For this reason, it is important to define as clearly as possible which consequential damages are included in any waiver. Also, while most standard construction contracts specifically address issues like increased overhead, delay damages, material escalation costs and other items that might otherwise be caught up in a consequential damages waiver, other types of agreements commonly used in the industry – for example design-build, teaming agreements or joint venture agreements – may not. Thus special care must be taken when waiving consequential damages in non-standard agreements.

Conclusion

Before agreeing to a blanket waiver of consequential damages, parties should consider what they will be gaining as well as what they will be giving up. One approach is to simply remove the consequential damages waiver entirely, and if there are particular types of damages the parties wish to exclude, such as claims for loss of business reputation or increased credit costs, those can be specifically excluded. However, consequential damages waivers are so commonplace and so widely accepted that it is often difficult to have them removed, leaving parties to negotiate for what sorts of consequential damages should be allowed. This is the approach taken by the AIA and FDOT, which starts with a blanket waiver by the contractor of consequential damages, but then uses other provisions to add back a right to a claim for certain types of costs.

From whichever direction one approaches the problem, care must be taken not to inadvertently include or exclude a particular category of damages contrary to the wishes and understanding of the parties.



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- ¹ ¶15.16.1: Owner waives damages for “rental expenses, for losses of use, income, profit, financing, damage and reputation, and for loss of management or employee productivity or of the services of such person.”
- ² ¶15.16.2: Contractor waives damages for “principal office expenses including the compensation of personnel stationed there, for losses of financing, business and reputation, and for loss of profit except, anticipated profit arising directly from the Work.”
- ³ See Hadley v. Baxendale 156 Eng. Rep. 145 (1854).
- ⁴ General Damages, Black’s Law Dictionary (2014).
- ⁵ Consequential Damages, Black’s Law Dictionary (10th ed. 2014); see also Dorestin v. Hollywood Imports, Inc., 45 So. 3d 819, 830 n.14 (Fla. 4th DCA 2010) (consequential are those that “do not necessarily, but do directly, naturally, and proximately result from the injury for which compensation is sought”).
- ⁶ Bartram, LLC v. C.B. Contractors, LLC, 2011 WL 1299856 at *2 (N.D. Fla. March 31, 2011).
- ⁷ DaimlerChrysler Motors Co., LLC v. Manuel, 362 S.W.3d 160, 181 (Tex. App. 2012) (internal citations and quotations omitted).
- ⁸ T.Co Metals, LLC v. Dempsey Pipe & Supply, Inc., 592 F.3d 329, 340-41 (2d Cir. 2010).
- ⁹ American Home Assurance Co. v. Larkin Gen. Hosp., Ltd., 593 So. 2d 195, 196 (Fla. 1992).
- ¹⁰ United States v. Rice, 317 U.S. 61 (1942).
- ¹¹ In re Electric Machinery Enterprises, Inc., 416 B.R. 801, 845 (Bankr. M.D. Fla. 2009) aff’d in part sub nom. In re Electric Machinery Enterprises, Inc., 474 B.R. 778 (M.D. Fla. 2012).

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