

The Waiver of Consequential Damages in the A201 General Conditions

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The 1997 edition of AIA document A201, General Conditions of the Contract for Construction, contains a new concept not present in prior editions: a mutual waiver of consequential damages. Located at paragraph 4.3.10, the provision calls for the Owner and Contractor to waive consequential damages as to each other, and for the Architect to be included in this waiver if the Owner and Architect sign a similar agreement and tender it to the Contractor within 30 days of the signing of the construction contract.

Most analysts of this provision agree that it favors the Contractor. In many sectors of the construction industry, most particularly the industrial sector, it is a common practice for contractors to insist that a clause waiving consequential damages be included in the construction contract. The theory underlying the waiver is that the Owner's damages from loss of use may dwarf and bear no relationship to the amount of the construction contract, subjecting contractors to potentially ruinous liability out of all proportion to the magnitude of the construction contract.

The AIA appears to have been influenced by the case of Perini Corp. v. Greate Bay Hotel & Casino, 129 N.J. 479, 610 A.2d 364 (1992). In the Perini case, an arbitrator awarded the Sands Hotel and Casino more than \$14,500,000 in damages for lost profits against the general

contractor, Perini, whose contract was worth approximately \$24,000,000 with a fee of \$600,000. The result in the case has drawn considerable outrage because a substantial portion of the damages award was for the failure to complete an ornamental facade that had no other function but to attract customers, based on the hotel's contention that it intended to "increase its profits by attracting more patrons" from the surrounding area. Thus, delayed completion of this relatively minor, non-functional element of the project resulted in multiple millions of dollars of delay damages.

The new waiver of consequential damages clause raises the following important issues.

The Law and Philosophy of Consequential Damages. The law of consequential damages is usually traced back to the English case of Hadley v. Baxendale, 9 Ex. 341, 156 Eng. Rep. 145 (1854), in which the court adopted a rule that has been followed ever since: that consequential damages will only be available as compensation for a breach of contract if they were within the reasonable contemplation of both parties at the time they entered into the contract. The court described general or direct damages as those which would normally be considered to arise in the usual course of events without regard to any special circumstances of the non-breaching party. In contrast, consequential damages were defined as secondary consequences of nonperformance resulting from the special circumstances of the non-breaching party.

The law of consequential damages is a function of tension between two well-established legal principles. One principle is the goal of compensating the victim of a breach of contract. The other is the determination and enforcement of agreed allocations of risk.

The essence of the decision in Hadley v. Baxendale is that the agreed allocation of risk is more important than full compensation for the non-breaching party. Parties to a contract are deemed to have expected the normal and usual risks in the absence of specific contractual language to the contrary. Accordingly, general or direct damages, which represent the normal and expected risks, are always awardable. However, consequential damages, which represent additional risks due to unusual circumstances of the non-breaching party, are not awarded unless the non-breaching party can establish that the parties were aware of the special circumstances at the time they entered into the contract and therefore intended to allocate to the breaching party the extra risks resulting from the non-breaching party's unusual position. Consequently, as long as a contract clearly spells out what the parties intended, a court will generally enforce it as written unless the intentions are contrary to law or public policy.

Potential Problems in A201's Definition of Consequential Damages. Paragraphs 4.3.10.1 and 4.3.10.2 attempt to define by example the kinds of consequential damages that are waived. They are not intended to be exhaustive lists, since the sentence introducing the

subparagraph merely states that the waiver “includes” the types of consequential damages listed. This is known as the legal principle of *Ejusdem generis*, which according to Black’s Law Dictionary means that where general words are followed “by words of a particular and specific meaning, such general words are not to be construed in their widest extent, but are to be held as applying only to persons or things of the same general kind or class as those specifically mentioned.”

Section 4.3.10.1 is a list of consequential damages waived by the Owner. It explicitly waives delay consequences of the Contractor’s breach, including lost profits/use and time-related carrying costs. It also explicitly waives consequences to the Owner’s conduct of its own business, including issues of reputation and productivity. What remains is apparently just the cost of performing work which the Contractor failed to do or of repairing/replacing work performed improperly.

Nevertheless, the provision does not make clear whether certain categories of damages would be recoverable. For example, would additional fees paid to the Architect as a result of the Contractor’s breach be recoverable or be considered consequential damages? Paragraph 2.4.1 states that they are recoverable. If repairs to certain defective construction work require or make aesthetically preferable the modification of other unaffected work, would the cost of modifying the unaffected work be recoverable? Even though “loss of use” has been deleted as an item of indemnification, the scope of the Contractor’s indemnity obligations in

paragraph 3.18.1 arguably encompasses several categories of consequential damages; is the Contractor responsible for these consequential damages under the indemnity clause despite the Owner having waived its right to recover them in Section 4.3.10?

Section 4.3.10.2 lists the categories of consequential damages waived by the Contractor. Damages waived include those related to the Contractor's business and home office, as well as the consequences to other projects than the one which is the subject of the construction contract. Claims for extended home office overhead, under the Eichleay formula or otherwise, clearly seem to be waived. However, delay costs which manifest themselves as extended field overhead or additional costs for labor or materials would still be recoverable.

But there are a number of ambiguities or omissions in this section too. For example, are mark-ups for labor burden and other overhead factors waived, since these can be construed in an accounting sense as home office expenses that have been allocated among various billable elements? In cost-plus jobs, certain home office labor and expenses may be defined as a Cost of the Work under AIA document A111; how can an element that the parties agreed would be a compensable expense be unable to be included in a claim?

The Exception for Liquidation Damages. This exception may include a serious drafting error. Section 4.3.10 only provides an exception for liquidated damages when they are "liquidated *direct* damages." The

word “direct” is undefined and in the context of liquidated damages, appears to be illogical and inappropriate.

Liquidated damages are intended to be an approximation in advance of potential future consequences which would be difficult to quantify with precision. Sometimes inaccurately called penalty clauses (contract law does not permit enforcement of a penalty), they are usually employed in construction contracts to approximate the consequences to an Owner of delays in the completion of the construction project. At least in theory, they are calculated to be an approximation of the Owner’s actual damages, which means that liquidated damages by definition *take the Owner’s special circumstances into account*.

This means that any damages that are expressly liquidated would be allowed under the rule of Hadley v. Baxendale. Although they are purely consequential damages resulting from the special circumstances of the non-breaching party, their inclusion in the contract clearly demonstrates that the parties were aware of and contemplating them at the time that they entered into the contract. Accordingly, *any* mutually agreed and bargained-for liquidated damages should be awardable.

However, section 4.3.10 paradoxically seems to preclude awards of *indirect* liquidated damages. It is doubtful that this restriction accurately reflects current practice in the construction industry. Even in the industrial sector where waivers of consequential damages are routine, it is equally routine for the parties to agree on specific liquidated damages

for indirect consequences such as delayed completion or inadequate performance of the facility.

The entire concept of liquidated *direct* damages makes little sense. As section 4.3.10 has defined them, the direct damages (those not waived in the provision) are relatively simple to identify and quantify. For the Owner, it is the cost of performing or repairing and replacing defective construction work. For the Contractor, it is the actual labor, materials and field overhead costs incurred in performing the work. These costs can be determined with relative certainty, and in such situations liquidated damages are inappropriate and unenforceable.

The Architect's Participation. The last sentence of paragraph 4.3.10 provides for the waiver of consequential damages to apply to claims against the Architect if the Architect similarly waives such claims against the Contractor. In order for the waiver to be mutual, the Architect's separate agreement must be furnished to the Contractor within 30 days of the execution of the construction contract. This provision raises several interesting questions and issues.

First, it should be noted that the mutuality does not apply to the Architect's claims against the Owner or vice versa. Nothing in this provision requires the Architect to waive claims for consequential damages against the Owner or requires the Owner to waive claims for consequential damages against the Architect. The Architect's waiver refers to "any act or omission

of the Owner or Contractor,” but the Architect agrees to waive claims only against the Contractor for such acts or omissions. Of course, this does not prevent the Owner and Architect from separately agreeing to a mutual waiver of claims for consequential damages.

Second, section 4.3.10 refers to “a similar mutual waiver of all claims . . . for consequential damages”. It does not, however, define what constitutes consequential damages for an Architect. This raises the further question of whether the Architect’s waiver must include a list of categories of consequential damages, or whether it can be merely a conclusory sentence waiving consequential damages. Many courts have refused to enforce single-line non-specific waivers of consequential damages.

Finally, it is an interesting question whether the last sentence of section 4.3.10 creates a contractual relationship directly between the Architect and the Contractor. Although section 1.1.2(1) states that there is no such direct contractual relationship, there is little doubt that this provision intends to give the Contractor and Architect enforceable contractual rights against each other. It may be more nearly correct to describe the relationship between the Architect and Contractor as one of being mutual third-party beneficiaries to the portions of the two agreements that include waivers of consequential damages. Section 1.1.2 also says that the Architect is “entitled to performance and enforcement of obligations under the Contract intended to facilitate performance of the

Architect's duties." However, this language would not be sufficient in many states to give the Architect the status of a third-party beneficiary entitled to enforce the waiver of consequential damages. Furthermore, there is nothing in section 4.3.10 which requires the separate agreement for the waiver of consequential damages between the Owner and the Architect to name the Contractor as a third-party beneficiary.