

I WAIVED WHAT?

What it Means to Contractually Waive Consequential Damages

By: Mark T. Snelsonⁱ

Effective risk management in the construction industry begins with properly drafting a contract that shields away the unanticipated consequences of a project gone wrong. No matter where your company lies in the hierarchy of a construction project (owner, design professional, design subconsultant, general or prime contractor, subcontractor, sub-subcontractor, or material supplier), you are no doubt aware that the rights and remedies enjoyed by you and the party with whom you have contracted are primarily determined by the terms of your contract. One of the quintessential risk management provisions often included in construction contracts is a waiver of the right to recover consequential damages in claims between the contracting parties. You have almost certainly seen such provisions (commonly used AIA contract forms include clauses waiving consequential damages), and you may have signed contracts containing them in the past. However, have you ever wondered what exactly a “consequential damage” is, and, therefore, what you were agreeing to give up in the event your contractual relationship sours? The purpose of this

article is to explain the differences between “direct” or “general” damages and consequential damages, and to identify certain categories of damages typically considered to be consequential, so that you can be fully informed before agreeing or disagreeing to these often-arising contract provisions.

In Florida and many other jurisdictions, parties are generally free to contractually limit or waive claims for certain damages that may arise as a result of a breach of their contract, including claims for consequential damages.ⁱⁱ A typical example of a contractual waiver of consequential damages may read as follows:

The Contractor and Owner waive Claims against each other for consequential damages arising out of or relating to this Contract.

Many times the contract will then list specific examples or categories of damages being waived. Such provisions are not the exclusive province of owner-contractor agreements; consequential damage waivers frequently appear in contracts between

owners and design professionals and between general contractors and subcontractors.

An important question, then, is “What is a consequential damage?” To answer that question we have to understand the nature of “direct” or “general” damages that flow from a breach of contract. Direct or general damages are those costs that immediately and necessarily follow the violation of a contract. They “are commonly defined as those damages which are the direct, natural, logical, and necessary consequences of the injury.”ⁱⁱⁱ These are expenses that “follow immediately upon the act done” and “naturally and necessarily flow” from the breach of contract.^{iv} Examples of direct or general damages are easy to understand. An owner and a contractor agree to a contract that requires the contractor to replace the windows in the owner’s building for a price of \$15,000. The contractor mobilizes, removes the windows on the front of the building, and begins installing new windows. After the contractor has installed the first new window the contractor leaves the job and never returns to finish. The owner then hires a replacement contractor to finish the project at a price of \$20,000. In this example the owner has direct or general damages of \$5,000, the difference between the amount he would have paid to the original contractor to perform the job as

contracted and the higher amount he had to pay the replacement contractor.

There are many other examples in the context of deficient construction services. Let’s say a hotel owner retains a pool building contractor to expand and renovate the hotel pool, and, after completion and full payment to the contractor, the parties discover that the renovated pool leaks. Assuming the leak was a result of an act or omission on the part of the contractor, the hotel owner’s direct damage would be the cost to repair the leak.

By contrast, consequential damages are defined as damages that “do not flow directly and immediately from the act of the party, but only from some of the consequences or results of such act.”^v While they are the result or consequence of a breach of contact, they do not immediately spring from the breach because, to some extent, their existence depends on both the breach of contract and other circumstances. Florida courts have defined consequential damages as those expenses that are specific to the non-breaching party which typically stem from losses incurred by that party’s dealings with third parties that were reasonably foreseeable by the breaching party at the time of contracting.^{vi} It is evident from the definitions attached by legal authorities and commentators that,

next to the directness, immediacy, and necessity of the expense, a key factor in segregating consequential damages from general damages is whether the expense arose, at least in part, due to the involvement of a third party or circumstances other than the wrongful act itself. For instance, in the construction context, delay damages such as material escalation costs and additional interest and finance charges are typically classified as consequential damages.^{vii} The classification is to be expected considering these types of damages arise due to the impositions or requirements of parties that are outsiders to the breached contract. For instance, while the owner of a construction project has to pay more in interest to its lender as a result of its general contractor's breach of contract and delay in completing the job, the requirement to pay that interest is imposed by the terms of the agreement between the lender and owner.

Going back to the previous examples, if a storm came through between the time the original window installation contractor left the job and the replacement contractor started, and the storm caused water infiltration which ruined the hardwood floors in the owner's building, the costs to repair the floors would be the owner's consequential damages. If the hotel pool could not be used during the time it was leaking and the hotel lost guests and

revenue as a result, the lost revenue or profits would be the hotel owner's consequential damages.

It is difficult to identify all forms of damages that are classified as consequential, and the facts of each case and the other terms in the contract will influence whether a certain cost is ultimately determined to be a direct or consequential damage. However, as a general proposition, typical examples of consequential damages in the construction context include lost rents, rental costs for replacement property, damages to business reputation or the loss of goodwill, down time or idle time, material escalations, home office overhead costs, additional energy costs, increased construction management/supervision costs, and additional interest and finance charges. If you sign a contract waiving claims for consequential damages, these are the types of expenses you will not be able to recover from the party that breaches the contract. Now that you know what is at stake you can decide whether agreeing to a contract containing a waiver of consequential damages is prudent for your business.

ⁱ Mark Snelson is a Partner with the law firm Wright, Fulford, Moorhead & Brown, P.A. in Altamonte Springs, Florida. Mr. Snelson's practice is devoted to construction law. He has experience representing all tiers of the construction industry, including owners, design professionals, general contractors, subcontractors, and material suppliers. He can be

reached at (407) 425-0234, or
msnelson@wfmblaw.com.

ⁱⁱ See *Doctor Diabetic Supply, Inc. v. POAP Corp.*, 41 So. 3d 916 (Fla. 3d DCA 2010) (enforcing a contractual provision barring the recovery of consequential damages); *Action Orthopedics, Inc., v. Techmedica, Inc.*, 759 F.Supp. 1566, 1568 (M.D. Fla. 1991) (contracts may limit damages recoverable for breach of contract, and if such provisions are made, greater damages may not be awarded); *Marriott Corp. v. Dasta Constr. Co.*, 26 F.3d 1057, 1067 n.17 (11th Cir. 1994) (no damage for delay clauses in construction contracts are enforceable under Florida law); *Hardwick Properties, Inc. v. Newbern*, 711 So. 2d 35, 38 (Fla. 1st DCA 1998) (commenting that parties unquestionably enjoy the freedom to reasonably limit their respective remedies under a contract).

ⁱⁱⁱ *Florida Power Corp. v. Zenith Industries Company*, 377 So. 2d 203, 205 (Fla. 2d DCA 1979).

^{iv} Black's Law Dictionary (6th ed. 1991); *Hardwick Props.*, 711 So. 2d at 39.

^v Black's Law Dictionary (6th ed. 1991)

^{vi} *Hardwick Props.*, 711 So. 2d at 40; *Saey v. Xerox Corp.*, 31 F.Supp.2d 692 (E.D. Mo. 1998) (defining "consequential damages" as "such damage, loss or injury as does not flow directly from the act of a party, but only from some of the consequences or results of such act"); *Trimed, Inc. v. Sberwood Medical Co.*, 977 F.2d 885, 893 n. 7 (D. Mass. 1990) (same). Florida's Uniform Commercial Code defines consequential damages resulting from a seller's breach to include "[a]ny loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise."

§672.715, *Florida Statutes*.

^{vii} See Kenneth M. Block, *Time is Money: Contractual Treatment of Delay Damages*, New York Law Journal (Aug. 29, 2007) ("More often than not, consequential damages in the construction context result from delays in construction and can include . . . material escalation, additional increased interest costs, consultant expenses and lost profits."); see also Jason L. Richey and William D. Wickard, *Consequential Damages in Today's Construction Industry*, *Constructioneer* (May 5, 2008) <available at http://www.klgates.com/files/Publication/d2f0d5fa-7ebb-4c2c-9d96-94577868f2d7/Presentation/PublicationAttachment/35e1a2c8-ef0c-466d-aea0-9cd6af9dd6ca/constructioneer_article_richey.pdf>