I. INTRODUCTION

There is no reason that you should know this, but in my family we use the word "antelope" to describe unexpected and unplanned for events. For example, it is an "antelope" event if you're delayed while driving to the airport because a truck overturns on the highway, releasing its load of chickens, and the road is closed while the police, the Department of Agriculture and volunteers from the SPCA try to herd the panicking poultry in. This is more than normal rush hour traffic or even a fender-bender delay. This is a serious "oops".

Alligators, by contrast, act predictably. We know that they are likely to take a big bite out of whatever is nearby. If an alligator is hungry, and there is prey within its sights, the alligator quickly snaps it up and swallows it down.

Well, it is of antelopes and alligators that I think when I review the latest edition of the AIA A201 General Conditions of the Contract,¹ and, in particular the "mutual" waiver of consequential damages clause. Although this waiver has been promoted as being both fair and of benefit to the whole construction industry,² I think it fails of its purpose, leaving the parties with antelopes and alligators to address and avoid.

This paper will review the problems with the new waiver of consequential damages, beginning with the difficulty in defining the terms in the waiver and the resultant ambiguity. It will also explore other ambiguities in the contract language, with particular emphasis on the impact on liquidated damages clauses. It will also note the potential for contractors to recharacterize costs to avoid the results of the waiver. Finally, the paper will briefly outline some of the policy reasons for eliminating the mutual waiver.

The mutual waiver of consequential damages is one of the most significant changes in the A201 (1997), but it is by no means the only area of concern in the AIA family of documents.

¹ The latest edition of the AIA A201 General Conditions of the Contract for Construction will be referred to in this paper as A201 (1997).
² See Howard Goldberg, Memorandum to Documents Committee April 18-20, 1996, p.1: "By their subjective nature, these claims [for consequential damages] typically are the largest, most costly and the most likely to lead to a windfall to one party and economic disaster to the other. The possibility of a windfall recovery is one of the most substantial impediments to settlement in disputes over delays or change orders. Eliminating these exposures should substantially reduce the overhead cost of contractors for the benefit of the whole construction industry."
Attached to this article, as Appendix I, is an outline of some of the major issues facing owners and lenders when using the AIA’s most common construction contract delivery forms.

II. THE PROBLEMS WITH THE WAIVER

A. What Are Consequential Damages?

1. According to the A201 (1997).

New Subparagraph 4.3.10 of the A201 (1997) reads as follows:

4.3.10 Claims for Consequential Damages. The Contractor and Owner waive all claims against each other for all consequential damages arising out of or relating to this Contract. This mutual waiver includes:

.1 damages incurred by the Owner for rental expenses, for losses of use, income, profit, financing, business and reputation, and for loss of management or employee productivity or of the services of such persons; and

.2 damages incurred by the Contractor for principal office expenses including the compensation of personnel stationed there, for losses of financing, business and reputation, and for loss of profit other than anticipated profits arising directly from the Work.

This mutual waiver is applicable, without limitation, to all consequential damages due to either party's termination in accordance with Article 14. Nothing contained in this Subparagraph 4.3.10 shall be deemed to preclude an award of liquidated direct damages, when applicable, in accordance with the requirements of the Contract Documents.

New Subparagraph 4.3.10 lists examples of the “consequential damages” that the owner and the contractor are expected to waive. Other than the listed examples (such as, with respect to the owner, "rental expenses and loss of use, income, profit, financing, business... reputation, and...productivity..." and with respect to the contractor, "principal office expenses...loss of financing, business...reputation, and profits...other than [with respect to]...the Work"), there is no other definition,
reference or explanation provided in the document of what is intended by the mutual waiver of damages. Perhaps the intent of this provision is found by referring to other provisions of the General Conditions. For example, Subparagraph 1.2.5 of A201 (1997) provides that "well-known construction industry meanings" are to be used in interpreting the contract documents. Unfortunately, there are no recognized meanings to the words "consequential damages."

2. The Definition According to Case Law.

Although damages are a fundamental issue in breach of contract cases, no two courts or treatises define consequential damages in the same way. Further complicating the issue, the definitions used by the courts often appear to be at odds with the resulting categorization found by those same courts.

The ancient case of Hadley v. Baxendale still features prominently in present day discussions of consequential damages. Notwithstanding these ancient roots, a working definition of consequential damages in the context of construction contracts is difficult to come by. One court recently admitted that it had been unable to find any California case defining consequential damages.

Although this paper will not attempt a definitive discussion of the definition of consequential damages, it will point out the contradictions in the area and, thus, the opportunity for confusion and controversy.

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3 Subparagraph 1.2.5 of the A201 (1997) provides as follows: "Unless otherwise stated in the Contract Documents, words which have well-known technical or construction industry meanings are used in the Contract Documents in accordance with such recognized meanings."


6 See, e.g., Spang Industries v. Aema, 512 F.2d 365, 368 (2d Cir. 1975) ("Hadley v. Baxendale limits the recovery to those injuries which the parties could reasonably have anticipated at the time the contract was entered into."). The court went on to say that, "[t]here can be no question but that Hadley v. Baxendale represents the law in New York and in the United States generally." Id. Accord Ebasco Services, Inc. v. Pennsylvania Power & Light, 460 F. Supp. 163, 213 n. 62 (E.D. Pa. 1978) (discussing Pennsylvania law) ("The most famous case contrasting general and special (or consequential) damages is Hadley v. Baxendale . . ."). Accord Mendoyma, Inc. v. County of Mendocino, 8 Cal. App. 3d Supp. 873, 879-80; 87 Cal. Rptr. 740 (1970) (the doctrine announced in Hadley v. Baxendale, limiting damages to those reasonably foreseen by the parties, is followed in the Restatement of Contracts, and in California).

Consequential damages have been defined as:

1. damages that may not naturally flow from the breach but arise from special circumstances;

2. damages "which arise from the intervention of 'special circumstances' not ordinarily predictable...[and which] are compensable only if it is determined that the special circumstances were within the 'contemplation' of both contracting parties," and where "'contemplation' includes what was actually foreseen and what was reasonably foreseeable";

3. "damages that were caused by the breach, which were within the contemplation of the parties at the time of the contracting, and were reasonably foreseeable at the time of the contracting, and which are reasonably certain at the time of the contracting";

4. damages that the parties reasonably should have contemplated;

5. damages that typically result from late completion of the project but also that are peculiar to the injured party and "not expected to occur regularly to others in similar circumstances"; and

6. "ripple effects on the promisee's business from the breach".

Consequential damages are intended to be distinguished from damages that are otherwise called direct or general. These types of damages, however, are often defined in a similar manner. For example, direct damages in construction actions have been described as:

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12 Robert K. Cox, supra n. 9 at 3.

(1) damages "which, in the ordinary course of human experience, can be expected to result from a breach";  

(2) damages that are generally foreseeable as the result of a breach;  

(3) damages incurred as a result of a contractor's failure to exactly perform (although substantial performance has been rendered) unless otherwise waived;  

(4) damages that arise "outside considerations affecting the land itself"; and  

(5) "all unavoidable harm that the builder had reason to foresee when the contract was made."  

When comparing these lists, it is hard to distinguish between the definitions of direct damages and the definitions of consequential damages. Both speak of reasonable foreseeability and import other traditional notions of contract damages. At best, cases have suggested that general damages are those "ordinary damages that flow directly from the breach", with consequential or special damages as those "collateral losses, such as expenses incurred or gains prevented" resulting from the breach. But these descriptions, when applied in practice, seem to add little certainty to the discussion. The antelopes are everywhere. Nor does an analysis of specific examples of owner's or contractor's damages add any clarity to the discussion.

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14 Roanoke Hospital, supra, at 801.
15 Robert K. Cox, supra at 3.
18 Young v. Johnston, 475 So. 2d 1309, 1314 (Fla. Dist. Ct. App. 1985) (quoting Restatement (First) Contracts, § 346(1)(a)).
20 Reference to Federal Acquisition Regulations, Part 31 Contract Cost Principles and Procedures, CCH Government Contracts Reports (1997), also provides little or no assistance. FAR 31.202 defines "direct costs" as any cost that can be identified specifically with a final cost objective. FAR 31.203 defines "indirect costs" as any cost not directly identified with a single, final cost objective but identified with two or more cost objectives, or pooled costs allowed by contract terms. In a fine example of circular reasoning, "final cost objective" is defined as a cost objective that has allocated to it both direct and indirect costs.
a. Owner's Compensatory and Consequential Damages.

One of the most significant examples of consequential damages may be lost profits. Indeed, the award of $14.5 million in lost profits in *Perini Corp. v. Greate Bay Hotel & Casino, Inc.*\(^{21}\), is reported to be the impetus for the inclusion of the limitation on consequential damages in the A201 (1997).

The *Perini* award contained two parts, those lost profits arising after the intended completion date but before substantial performance, and those lost profits arising after substantial performance. The court allowed lost profits after the point of substantial completion, because even at this point, the ornamental facade intended to attract customers had not been completed. The court determined that the failure to construct the facade could reasonably be expected to affect the attraction of patrons, not only in the summer season immediately following the contracted-for completion date, but also carrying through the winter months.\(^{22}\) These damages, if they had arisen under the A201 (1997), likely would not be available to an owner. At least that is one intended result.

However, some jurisdictions have labeled the owner’s lost profits as actual damages. For example, the court in *Oliver B. Cannon & Son, Inc. v. Dorr-Oliver, Inc.*\(^{23}\), treated lost profits, including depreciation, as a direct loss, although the court reversed and remanded the judgment because it determined the method used to calculate lost profits was speculative.

In *Cannon & Son*, a painting subcontractor was held liable to a factory owner for over half a million dollars in lost profits, over one-fifth of which constituted depreciation of buildings and equipment during a shutdown caused by the subcontractor. Similarly, in *Northern Petrochemical Co. v. Thorsen & Thorshov, Inc.*\(^{24}\), the court upheld a jury award of $267,000 for profits lost to the owners of a plastic extrusion factory due to delayed occupancy of the building. Although the courts did not clearly classify loss of profits and loss of use as either direct or

\(^{21}\) 129 N.J. 479 (1992) (arbitrators awarded over $14,500,000 in lost profit damages arising out of delayed opening to casino owner against general contractor employed to manage the casino renovation project).

\(^{22}\) *Id.* at 507.

\(^{23}\) 394 A.2d 1160, 1163 (Del. 1978).

\(^{24}\) 297 Minn. 118, 123-124, 211 N.W. 2d 159 (1973).
consequential damages, it characterized such as the "proper subject of damages where...the loss is a direct and proximate result of the injury complained of and the damages are within the contemplation of the parties at the time of making the contract", terminology often used to describe direct damages. The court went on to state that loss of profits is an appropriate measure of damages resulting from the loss of use "when the anticipated profits can be proved to a reasonable, although not necessarily absolute, certainty."

Other types of damage actions have spawned equally confusing results. Interest payments on debt to finance a project may be either compensatory or consequential damages. In Roanoke Hosp. Ass'n v. Doyle & Russell, Inc. they were both. In Roanoke, a hospital brought suit for damages due to the contractor's failure to complete on time. The court concluded that "added interest costs (including expenditures on borrowed funds and interest revenue lost on invested funds) during the construction period arising from the longer term of borrowing necessitated by the contractor's unexcused delays" are direct damages because it is well known that "construction contracts...require third-party financing." These costs were distinguished from increased costs due to higher interest rates during the extended term, because the court deemed these to be "unpredictable" or arising from special circumstances. It is difficult to understand how this relates to Subparagraph 4.2.10, which seems to provide that all "financing" costs are waived.

In Hemenway Co. v. Bartex, Inc. of Texas the court permitted recovery for both extended rental payments and interest on interim financing. These were viewed as appropriate elements of delay damages. However, in Brewhouse, Limited v. New Orleans Public Service Inc., the

25 Id. at 125.
26 Id.
28 Id.
30 Id. at 359.
court did not allow recovery for additional interest during the delay, but only for lost rents because no take-out financing was in place or delayed.

In *J.W. Plaisance v. Malcom Duton*,\(^{32}\) the court awarded the owner additional living expenses when the contractor failed to provide an accessible all-weather road and driveway for the owner's mobile home by the contracted for date, as these expenses "were reasonably within the contemplation of the parties at the time of making the contract." The court determined that the contractor laid a defective road, rendered useless by heavy rains, causing the owner to delay delivery of the mobile home and to store his furniture elsewhere. The court makes no distinction between consequential and direct damages, but simply characterizes all of the costs as within "the contemplation of the parties at the time of the contract."\(^{33}\)

The cost of storing furniture or equipment to be delivered to the site in anticipation of the contracted-for completion date would not be recoverable under A201 (1997), although such losses clearly were found foreseeable and contemplated by the parties.\(^{34}\) Even the owner in *Cooperstein v. Patrician Estates*\(^{35}\) would presumably be denied the benefit of his bargain and anything in the way of damages from the contractor who took nine months to complete one month's work.

b. Contractor's Compensatory and Consequential Damages.

As with the description of owner's damages, courts and commentators often fail to characterize damages as compensatory or consequential. Rather, damages generally are grouped only as recoverable or not.\(^{36}\)

For example, in *Moore Constr. Co., Inc. v. Clarksville Dep't. of Elec.*\(^{37}\), Clarksville hired Moore to do certain site preparation and exterior work, and engaged Kennon Construction Company to erect the office

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33 *Id.* at 1036.
34 *Id.* See also *Fairfax County Rede. v. Hurst & Assoc.*, 231 Va. 164, 343 S.E. 2d 294 (1986).
36 *See e.g.* Steven G.M. Stein, *supra* n. 11, § 11.02(2).
building and warehouse.\textsuperscript{38} The project required the work to be performed in sequence, with first Moore then Kennon, and then Moore again.\textsuperscript{39} Kennon experienced problems during its work, leading Moore to incur a variety of damages, including an increase in the cost of materials, overhead, insurance, bonding, supervisory and central office labor costs, loss of use of equipment, loss of interest on retainage, and loss of interest on anticipated income.\textsuperscript{40} The court found "that it is reasonably foreseeable that a contractor, whose ability to complete its work is impaired by the owner and whose performance is thereby substantially delayed, will suffer direct damages and that the extent of these damages will depend on the unique facts of each case."\textsuperscript{41}

The court did not make a distinction between the definitions of compensatory and consequential damages, but simply determined which costs were the foreseeable, direct results of the delay. There is no indication that the use of the word "direct" was intended to convey any meaning as to the nature of the damages other than that they were foreseeable.

The court did not permit recovery for Moore's loss of use of the interest accruing on its retainage or its loss of use of the interest it might have been able to earn on the contract funds that remained unpaid while the delayed work was completed.\textsuperscript{42} Denial of recovery was not based on the characterization of the type of damages but on the speculative nature of the evidence presented.

In \textit{Indiana & Michigan Elec. Co. v. Terre Haute Indus. Inc.}\textsuperscript{43}, the court upheld an award of damages arising from delays caused by inclement weather, improper performance by other contractors and I&M's interference. In contrast to clause 4.3.10.2, the court labelled as

\begin{itemize}
\item \textsuperscript{38} \textit{Id.} at 3-5.
\item \textsuperscript{39} \textit{Id.}
\item \textsuperscript{40} \textit{Id.} at 6.
\item \textsuperscript{41} This seems to combine the definitions of compensatory and consequential damages.
\item \textsuperscript{42} \textit{Id.} at 14.
\item \textsuperscript{43} 507 N.E.2d 588, 591-592 (Ind. Ct. App. 1987).
\end{itemize}
compensatory damages, among other things, expenses incurred for delays, including overhead and supervision.\textsuperscript{44}

B. Further Ambiguity.

1. \textit{Are the Contract Documents Complementary?}

As discussed at length above, there is no clear definition in the case law or in Subparagraph 4.3.10 of what constitutes consequential damages and, therefore, what damages are waived. There also is little rationale presented as to why one category of foreseeable damages should be included and another excluded.\textsuperscript{45}

The provision purporting to waive all consequential damages does not contain a definition, but it provides that certain identified items are not recoverable costs. Subparagraph 4.3.10 uses the word "includes", not the words "includes, without limitation". Is the list intended as illustrative only, with all other provable damages acceptable? Or, is the list intended as examples only, providing a general idea of the specific damages that are waived?

This issue is further complicated because the first sentence in Subparagraph 4.3.10 following the list uses the phrase "without limitation" to describe the applicability of the waiver for the termination provisions of the A201 (1997). Clearly, then, the drafters are aware that this type of modifier can be used.

Subparagraph 1.2.1 of A201 (1997) provides that the various agreements between the owner and contractor and other documents that constitute the contract, are "complementary". Generally, that means the documents should be read together, with the provisions of one filling out or completing the provisions of the others. How, then, does Subparagraph 2.2.1 relate to the waiver of recovery of financing costs required by Subparagraph 4.3.10?

Subparagraph 2.2.1 of A201 (1997) requires the owner to provide the contractor with evidence of the owner's financing of the project. This requirement is a condition precedent to the contractor beginning or continuing work. Indeed, the owner is not permitted to vary its financial arrangements materially without notice to the contractor. If the contractor knows that the owner must obtain financing, and the owner is obligated to open its financial arrangements to

\textsuperscript{44} Id. at 599 (emphasis added).

\textsuperscript{45} Commentators may argue that a party should not assume a risk not commensurate with any possible reward. Isn't the question, rather, whether an aggrieved party should be denied the benefit of its bargain by the party causing, and in a position to control, the breach?
inspection by the contractor, why is not interest a foreseeable, direct form of damages?

There are other examples where the forms may not be internally consistent. Assume, for the moment, that the A201 (1997) is accompanied by another AIA document, the A111 (1997). Subparagraph 7 of the A111 (1997) identifies the costs of the work for which the contractor may be paid.

Subparagraph 7.2.2 provides an opportunity to reimburse wages or salaries of personnel stationed at the contractor's principal or other non-site offices if the parties agree. If the parties agree, are these same types of costs waived under Subparagraph 4.3.10 if an owner default causes delays? Surely the contractor would expect to recover as a element of damages, at least those items it is permitted as a cost of the work. That result, however, might not be the case, and another antelope might be the result instead.

It is difficult to understand how Subparagraph 1.2.1 of the A201 (1997) (that all documents are complementary) can be given effect when Subparagraph 7.2.2 of the A111 (1997) (permitting recovery for home office personnel) and Subparagraph 4.3.10 of the A201 (prohibiting recovery for home office personnel) are mutually exclusive. The language of Subparagraph 4.3.10 is not permissive. It states absolutely that: included within damages waived are "[d]amages incurred by the Contractor for principal office expenses including the compensation of personnel stationed there..."

Similarly, how will the contractor recover "[d]ata processing costs related to the Work"? These are permitted costs of the work under Subparagraph 7.6.6 of A111 (1997). However, might these costs also be characterized as home office overhead costs, arguably not permitted by clause 4.3.10.2 of A201 (1997)?

This article is written from the owner's perspective, so you might wonder why it points out items of the contractor's recovery. The answer is simple. If the contract is not clear, it will spawn controversy and litigation. Disputes benefit no one.

What about other provisions of the A201 (1997)? They are equally unhelpful and confusing.

Paragraph 2.4 permits an aggrieved owner to perform the contract work if the contractor, after notice, fails to do so. The owner may thereafter deduct from
payments due to the contractor "the reasonable\textsuperscript{47} cost of correcting such deficiencies, including Owner's expenses and compensation for the Architect's additional services made necessary by...[the contractor's] default, neglect or failure."\textsuperscript{48}

Will the owner, pursuant to this provision, be able to collect for the loss of management or employee productivity arising out of the contractor's default because, for example, such individuals must undertake the contractor's work or correct the contractor's errors. Under Subparagraph 2.4.1, I would say "yes". Under clause 4.3.10.1, maybe not.\textsuperscript{49}

Subparagraph 3.2.3 creates a similar dilemma. It states that if the contractor does not review the Contract Documents for errors, omissions and inconsistencies or fails to report those errors, omissions or inconsistencies it discovers, the contractor "shall pay such costs and damages to the Owner as would have been avoided if the Contractor had performed such obligations."

Suppose the contractor has been engaged to build the first branch offices of a bank newly arrived to the state. Suppose further that the contractor recognizes that the load bearing capacity of the branch will not support the safe, deposit boxes and other necessary equipment, but that the contractor fails to mention that fact to the architect or owner. For what should the contractor be liable?

Under Subparagraph 4.3.10, the contractor would argue that the owner should be entitled to, at most, the work related to the added structural support. All of the costs and expenses relating to the fact the grand opening was delayed, furnishings and equipment had to be stored off site and other foreseeable damages such as loss of business reputation occurred, will be borne by the innocent party least able to identify or control the risk, that is, the owner. So much for fair and equitable risk allocations.

In contrast to Subparagraph 3.2.3, Subparagraph 3.7.4 is more clear in its description of the damages available to the owner in the event of certain contractor defaults. There, if the contractor performs work "knowing it to be

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\textsuperscript{47} Although not within the scope of this paper, one wonders why the Owner should be limited to an objective standard of reasonableness rather than the actual cost resulting directly from the contractor's default, neglect or failure. This standard is a new addition to the A201 (1997).

\textsuperscript{48} A201 (1997) Subparagraph 2.4.1.

\textsuperscript{49} The AIA made sure, at least, that the Architect's compensation would not be at risk. Subparagraph 2.4.1 maintains the prior provision allowing compensation for the Architect's additional services.
contrary to laws, statutes, ordinances, building codes, and rules and regulations with...notice to the Architect and Owner, the Contractor shall...bear the costs attributable to correction." So, when the contractor knows its work violates the law, it bears the cost of correction. When the contractor knows its work is in error, it pays the costs and damages that could have been avoided.

Are these intended to be two different measures of damages? If so, perhaps our bank owner is not out of luck after all, although it is hard to understand why knowingly failing to report a design flaw is worse than knowingly performing work that is contrary to law. If the measure of damages is meant to be the same, why isn't the language identical?

What about the contractor who simply completes the work defectively? Direct damages likely would be the cost of repairing or replacing the defective construction. Where the repair or replacement would involve unreasonable economic waste, however, the owner's recovery of damages may be based on the difference in value of the completed work as compared to the value it should have had if the contractor had performed.

To what would an owner be entitled then, under the A201 (1997) and how would value be calculated? Without considering loss of income, profit or use, can a fair measure of damages be determined? Perhaps the result is not too harsh if the defective work is the failure of the diving board at a homeowner's pool, as in Ideal Pool Corp. v. Hupp. However, the result clearly would be unjust where the defective construction of a water system for a new hotel renders the hotel unsuitable for guests.

Subparagraph 3.17.1 provides that the contractor shall hold the owner and architect "harmless from loss" arising out of the contractor's infringement of

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50 A201 (1997), Subparagraph 3.7.4.
51 A201 (1997), Subparagraph 3.2.3.
copyright or patent rights. Again, suppose such infringement results in more than just the payment of damages to the holder of the copyright or patent? Suppose, as is often the case, a court grants an injunction against use. What if that causes the owner to be unable to open its business or renders an aspect of its facility unusable? Why shouldn't the infringer pay?

Subparagraph 5.4.2 seems to be wholly outside the strictures of the waiver of consequential damages. It provides that if a subcontract is assigned to the owner, and work has been suspended in excess of 30 days, "the Subcontractor's compensation shall be equitably adjusted for increases in cost resulting from the suspension." Arguably, although such a result is not logical, the subcontractor is entitled to compensation for lost business opportunities and increased costs in home office overhead, since the waiver of such claims applies only to the contractor and owner. Perhaps the owner will argue that the subcontractor has waived such claims because of the flow-down provisions of Subparagraph 5.3.1. However, waivers of rights are strictly construed, and it would be imprudent to rely on such where substantial sums may be at risk.

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56 Subparagraph 5.3.1 of A 201 (1997) provides as follows:

5.3.1 By appropriate agreement, written where legally required for validity, the Contractor shall require each Subcontractor, to the extent of the Work to be performed by the Subcontractor, to be bound to the Contractor by terms of the Contract Documents, and to assume toward the Contractor all the obligations and responsibilities, including the responsibility for safety of the Subcontractor's Work, which the Contractor, by these documents, assumes toward the Owner and Architect. Each subcontract agreement shall preserve and protect the rights of the Owner and Architect under the Contract Documents with respect to the Work to be performed by the Subcontractor so that subcontracting thereof will not prejudice such rights, and shall allow to the Subcontractor, unless specifically provided otherwise in the subcontract agreement, the benefit of all rights, remedies and redress against the Contractor that the Contractor, by the Contract Documents, has against the Owner. Where appropriate, the Contractor shall require each Subcontractor to enter into similar agreements with Sub-subcontractors. The Contractor shall make available to each proposed Subcontractor, prior to the execution of the subcontract agreement, copies of the Contract Documents to which the Subcontractor will be bound, and, upon written request of the Subcontractor, identify to the Subcontractor terms and conditions of the proposed subcontract agreement which may be at variance with the Contract Documents. Subcontractors will similarly make copies of applicable portions of such documents available to their respective proposed Sub-subcontractors.

57 See Psaty & Fuhrman, Inc. v. Housing Authority of City of Providence, 68 A.2d 32, 35 (R.I. 1949) (a contract clause prohibiting payment of damages for delay or hindrance calls for strict application); S.L. Rowland Constr. Co. v. Beall, Piper and Tank Corp., 540 P.2d 912, 918 (Wash. Ct. App. 1975) (construction contract provision waiving the right to damages for delay will be strictly construed); Owen Constr. Co. v. Iowa State Department of Transportation, 274 N.W.2d 304, 306 (Iowa 1979) (the general rule is that a "no damage" clause in a contract is valid, but due to the harsh results induced thereby, will be strictly construed).
The contractor is required to purchase certain insurance coverages, including protection against "claims for damages...because of injury to or destruction of tangible property, including loss of use resulting therefrom." What does this mean? Elsewhere in A201 (1997) the phrase "loss of use" has been deleted, most notably in the contractor's indemnification of the owner in Paragraph 3.18. Is the requirement in Clause 11.1.1.5 vestigial or intentional?

There is similar confusion in the owner's insurance requirements. For example, Clause 11.3.1.1 requires the owner to carry property insurance including "compensation for Architect's and Contractor's services and expenses required as a result of such insured loss." (emphasis supplied). Just what do these expenses entail?

There is no confusion, however, under the paragraph headed "Business Income Insurance". Here, in case the waiver set forth in Subparagraph 4.3.10 was not sufficient, the owner again "waives all rights of action against the Contractor for loss of use of the Owner's property, including consequential losses due to fire or other hazards however caused." The owner, who has no seat at the table when the AIA forms are drafted, once again goes hungry.

2. **Liquidated Damages.**

Subparagraph 4.3.10 expressly provides that nothing contained in it is intended to "preclude an award of liquidated direct damages" (emphasis added). There is no definition of what constitutes direct liquidated damages. Subparagraph 4.3.10 by its terms concerns "consequential" damages and does not use the term "direct" anywhere else in this provision. It is unclear, then, for what the owner may bargain.

The term "liquidated damages" refers to the specific sum of money that has been expressly agreed to by the contracting parties as the amount of damages

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58 Clause 11.1.1.5, A201 (1997).

59 Subparagraph 11.3.3, A201 (1997).

60 *Id.* In a recent case, a federal court, interpreting Mississippi law, narrowly construed the provision in AIA A107, Abbreviated Form of Agreement Between Owner and Contractor, mutually waiving rights for "damages caused by fire or other perils to the extent covered by property insurance...or any other property insurance applicable to the work." The court held that the waiver did not bar an insurer's claim for damages to nonwork property. In explaining its reasoning, the court states that if the parties had intended that the contract should waive all claims against each other, they would have so provided. *Fidelity and Guaranty Ins. Co. v. Craig-Wilkenson, Inc.*, 948 F. Supp. 608 (S.D. Miss. 1996). If the new A201 (1997) were part of the parties' agreement, the court presumably may have arrived at a contrary result.
recovered by either party for a specified breach by the other. The damages set forth in the agreement must be the result of the parties' good faith efforts to estimate the actual damage that likely will ensue from the contract's breach. Because the amount agreed to is an estimate, the exact amount of the damages is uncertain and not readily capable of ascertainment. Indeed, liquidated damage clauses generally will be upheld only if, at the time the contract was made, it appeared that the harm flowing from the breach would be difficult to estimate. This type of agreed damage clause is extremely helpful where damages from breach may involve intangible, remote, or hard to prove elements, but where such damages are nevertheless real.

In sum, liquidated damages clauses by nature are uncertain and, in practice, may give the non-breaching party more or less than their actual losses. In exchange for saving time that would be spent calculating exact damages, the parties accept the fact that the agreed on amount may over or under compensate the injured party.

In contrast, direct damages are those that flow naturally or ordinarily from a contract breach. Direct damages are compensable because they are the expected result from the breach. Unlike "consequential" damages, direct damages generally are predicable and "undeniably" within the contemplation of the parties at the time the contract was drafted.

Direct damages by nature may be more easily identified and quantified. In contrast, courts generally uphold liquidated damages clauses only if the harm flowing from the breach is difficult to estimate accurately and the non-breaching party would be unable to prove his or her damages exactly. The term "liquidated direct damages", therefore, attempts to merge two concepts that may be mutually exclusive, or that at least contain contradictory elements.

62 In re Plywood Co. of Pa., 425 F.2d 151, 154 (3d Cir. 1970).
65 Id.
As previously noted, courts uphold and enforce liquidated damages as they pertain to uncertain and intangible damages.\textsuperscript{69} If the agreed-to amount is reasonable, courts will routinely enforce the liquidated damages clauses. Indeed, courts view liquidated damages as a good thing. Such clauses minimize trial time, make for greater certainty, serve to limit the exposure of the parties and thus encourage enterprise. For this reason, courts may resist any restrictions or qualifications added to liquidated damages clauses.\textsuperscript{70}

Courts may be especially resistant if the qualification to a liquidated damages clause only adds confusion. When the word "direct" is added to the liquidated damages clause, the intent and interpretation becomes unclear. As far as I have been able to determine, no court or commentator has defined these three words when used together. The addition of the word "direct" into an established contractual concept may dismantle a helpful tool. The result certainly will be an increase in litigation.

The merging of "direct" and "liquidated damages" may cause contracting between contractors and owners to become more difficult, cumbersome and less productive. The marriage of "liquidated" damages to "direct" damages could cause courts to interpret the term to mean that liquidated damages only cover injuries flowing directly from a contract's breach. To the extent that the flexibility of a liquidated damages clause facilitated, expedited or enabled an agreement to be reached, contractor and owners could suffer as a result of its demise.

It has been suggested that the term "direct" was added to the description of liquidated damages to prevent the contracting parties from doing indirectly what they waived the right to do in Subparagraph 4.3.10. The theory is that if the contracting parties waive claims to consequential damages, they should not be able to recover for such damages through a liquidated damages clause. With the confusion as to what constitutes consequential and direct damages, however, the additional language is unlikely to provide any clarity.\textsuperscript{71}

\textsuperscript{69} \textit{Id.}

\textsuperscript{70} \textit{Id.}

\textsuperscript{71} \textit{See, e.g., nn. 5-45 supra. See also Otis Elevator Co. v. Standard Constr. Co., 92 F. Supp. 603, 607 (Minn. Ct. App. 1990), quoting Liljengren Furniture & Lumber Co. v. Mead, 42 Minn. 420, 44 N.W. 306 (1890) ("where the contractor or builder engages to construct and complete a building by a certain time, having the entire control and responsibility of its construction...the loss of the use of a building may be said to be the direct and inevitable result of a failure to complete it within the time specified").
Whether damages from breach of contract are direct or consequential is a question of law,\textsuperscript{72} and often a question of jurisdiction. For example, attorney's fees are generally not recoverable unless a breach of contract has forced a plaintiff to maintain or defend a suit against a third person. In that circumstance, however, the fees may constitute a direct damage.\textsuperscript{73} Furthermore, although lost profits may be seen as consequential damages in many circumstances, unpaid fees accruing under a service contract, including elements of profit, may constitute direct damages.\textsuperscript{74}

In summary, the phrase "liquidated direct damages" attempts to unify two very different concepts of damages. The definition of direct damages (as opposed to consequential damages) is by no means clear. As a result, the addition of the term "liquidated direct damages" is likely to cause increased uncertainty and litigation.

3. \textit{How "Similar" is "Similar"?}

The waiver of consequential damages is applicable to claims by the contractor against the architect if the owner procures a "similar" mutual waiver of claims from the architect against the contractor. How similar is similar? If there are carve-outs for the architect for some items that arguably are consequential damages, is this still similar? Who decides, and when is that decision made? And who is most likely to suffer consequential damages and at what cost?

4. \textit{How "Mutual is "Mutual"?}

The list of consequential losses that are waived by the owner is not identical to the list of losses waived by the contractor. Some may be explained because the item may belong peculiarly to one entity or another, such as loss of use being an item of owner's damage and not of contractor's damage. Other items are not as clear, such as "rental expenses". There, the owner is precluded from recovery but the contractor is not. Also, the owner is prohibited from the recovery of its lost profit and income, but the contractor is specifically allowed profit arising directly from its work.

C. \textbf{The Biggest Antelope of All -- Recharacterization of Costs.}

\textsuperscript{72} \textit{Id} at 481.


\textsuperscript{74} See, \textit{e.g.}, \textit{Combustion Systems Services, Inc. v. Schuylkill Energy Resources, Inc.}, 1993 WL 496946 (E.D. Pa. 1993) (holding that if a breach occurs because a party does not pay fees it was contractually obligated to pay, the fees can be recovered by the injured party as direct damages).
1. The Impetus for Recharacterization of Costs.

If a contractor is faced with the loss of substantial categories of damages, it is not unreasonable to expect that it will look for other ways to recover its costs. Simply increasing its bid is an unlikely result, because the contractor will not want to lose its competitive edge. The contractor, then, may resort to recharacterizing "indirect costs" as "direct costs", thus increasing costs to the owner both in situations involving change orders, as well as damages for breach. This cannot be an intended result.

2. Examples of Recharacterization.

Under the present system, a contractor may account for craft labor, forepersons and field superintendents as a direct cost of the project. The project manager may or may not be a direct cost. A corporate officer generally will be an indirect cost.

As with personnel costs, materials and equipment may be direct or indirect costs. Materials installed in the work clearly are direct. Construction equipment stationed at the job site, if needed for the work and used exclusively for the work, also will be a direct cost. Items such as fuel and equipment maintenance may fall into either category. Home office supplies generally will be indirect costs, as will other elements of home office overhead such as accounting and payroll services, general insurance, rent, telephone and facsimile and other administrative expenses.

What is to prevent a contractor from allocating formerly indirect categories of expenses to direct categories? A portion of the home office could be redesignated as exclusively project related, with its personnel and equipment accounted for as such. Although one might argue that such a change will be cumbersome or difficult, once a revised accounting system is put into place, I believe it could quickly become routine.

In a presentation on July 30, 1997 to the Construction Contracts Committee of the Philadelphia Bar Association, two consultants, Evans M. Barba, P.E., CEO of Barba-Arkhon International Inc., and Robert S. Bright, Senior Manager of Price Waterhouse LLP, both argued that it would be relatively easy to make the necessary changes. The main caveat of their thesis was that the
 contractor would have to apply consistently its new accounting methodologies to all of its projects. That requirement, however, is not new where enforcement of claims is involved.  

What a herd of antelopes trampling the owner if the result of the mutual waiver of consequential damages is more money to the contractor for indirect costs and a bigger profit component, all at the owner's (and the project's) expense!

III. POLICY ISSUES.

A. Mitigation of Damages.

In eliminating an award of consequential damages, Subparagraph 4.3.10 places the burden of mitigation of damages on the non-breaching party. In instances where direct, out-of-pocket costs are not substantial (although the consequential costs may be), a contractor may choose to breach its contract with the owner to fulfill another contract that it finds more profitable. Alternatively, the contractor may realize that due to unforeseen circumstances, the project may be delayed, leading to substantial consequential damages for the owner. The contractor's incentive to mitigate the effects of the delay are limited to the damages the contractor may incur.

Knowing that it faces this possibility, a risk adverse owner may spend much of the executory period of the contract preparing to mitigate potential losses. This preparation, whether in the form of insurance, a built-in time cushion, or a constant readiness to have another party step in, will undoubtedly cost money. For example, in allowing for extra time for completion, the owner may sacrifice the ability to sign leases with tenants who need an early lease commencement date. Thus, the owner pays a premium to prevent consequential losses and good economic business practice is sacrificed.

This result is contrary to established principles of mitigation. A nonbreaching party should not be required to take mitigating action that the breaching party is equally able to take.

B. Allocation of Risk.

The general principle of limited recovery of consequential damages should be that if a risk of loss is known to only one party to the contract, the other party is not liable for the loss if it occurs. This principle induces the party with knowledge of the risk either to

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76 Records must be compiled in accordance with "sound and recognized accounting principles". *Southern New England Contracting Co. v. State*, 345 A.2d 550 (Conn. 1974).

77 Robert K. Cox, *supra*, n. 9 at 12, n.193.
take appropriate precautions himself or herself or, if he or she believes that the other party might be the more efficient preventer or spreader (insurer) of the loss, to reveal the risk to that party and pay the other party to assume it. Incentives are thus created to allocate the risk in the most efficient manner.\textsuperscript{78} A clause limiting liability represents the agreement of the parties "on the allocation of the risk of economic loss in the event that the contemplated transaction is not fully executed, which the courts should honor."\textsuperscript{79}

The discussion on mitigation highlights the fact that Subparagraph 4.3.10 effectively allocates the risk of the contractor's breach to and assumption of consequential damages on the owner. However, such assignment violates our notions of efficient distribution of risk since the contractor is in the better position to perceive trouble, avoid risk and minimize its consequences when trouble occurs. This is especially true in cases where, as is common, the owner is unfamiliar with construction practices. Information costs are greater to the owner than to the contractor. Societal resources will be wasted where the owner is forced to spend time preparing for and investigating a breach that the contractor is in a better position to foresee, prevent and correct.

\section{C. Punishment of the Breaching Party.}

Fundamental concepts of justice and public policy often point to punishment of wrongdoers. It challenges our concepts of fairness and fair play to let the breaching party off the hook and to cause the innocent party to bear its burdens without recourse.

Although in the context of a tort action, \textit{Story Parchment Co. v. Paterson Parchment Paper Co.},\textsuperscript{80} provides a concise explanation of our need to recover even difficult to measure damages rather than relieving the injuring party from the requirement to compensate the injured victim:

Where the tort itself is of such a nature as to preclude the ascertainment of the amount of damages with certainty, it would be a pervasion of fundamental principles of justice to deny all relief to the injured person, and thereby relieve the wrongdoer from making any amend for his acts. In such case, while the damages may not be determined by mere speculation or guess, it will be enough if the evidence show [sic] the extent of the damages as a matter of just and reasonable inference, although the result be only approximate. The wrongdoer is not entitled to

\begin{itemize}
\item \textsuperscript{78} Richard A. Posner, \textit{supra}, § 4.9 (3rd ed 1986).
\item \textsuperscript{79} Metropolitan Life Ins. v. Noble Lowndes Int'l, Inc., 84 N.Y.2d 430, 436 (N.Y. Ct. App. 1994).
\item \textsuperscript{80} 282 U.S. 555 (1931).
\end{itemize}
complain that they cannot be measured with the exactness and precision that would be possible, if the case, which he alone is responsible for making, were otherwise.\textsuperscript{81}

If the wrongdoer should be liable where damages are imprecise, why not when they are measurable and foreseeable but characterized as consequential?

IV. CONCLUSION: INCREASED WORK FOR LAWYERS

This paper is not intended to be unfettered criticism of the A201 (1997). Under the best of circumstances it is an impossible task to produce form documents that are acceptable to all parties for all purposes. In fact, that is one of my objections to using form documents of any kind. However, the hoopla surrounding the addition of Subparagraph 4.3.10, and the resultant pressure to use it, is of great concern to me. I believe that the one certainty of the inclusion of Subparagraph 4.3.10 in A201 (1997) is that litigators will have much to do.

John W. Hinchey, 1996-97 Chair of the ABA Forum on the Construction Industry, wrote of "Expanded Opportunities for Construction Lawyers" in the July, 1997 edition of \textit{The Construction Lawyer}.\textsuperscript{82} He posits that construction lawyers are "renaissance people" who can expand their practices by virtue of their many skills.\textsuperscript{83} I agree.

We need not increase the uncertainty and costs of construction projects to ensure employment. It serves no one to let the alligators gouge the owner while the antelopes stampede, all masquerading as risk allocation.

\textsuperscript{81} \textit{Id.} at 563.

\textsuperscript{82} Vol. 17 No. 3, p.21, July, 1997.

\textsuperscript{83} \textit{Id.}
DEVELOPING THE PROJECT –
WHAT’S NEW IN THE YEAR 2000

AIA CONTRACT DOCUMENTS:
OF ANTELOPES AND ALLIGATORS –
THE AIA A201 WAIVER OF CONSEQUENTIAL DAMAGES
FROM THE OWNER'S PERSPECTIVE
AND OTHER TROUBLING TALES

ACREL SPRING 2000 MEETING
MARCH 30 - APRIL 2, 2000
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Presented by
Lynn R. Axelroth, Esquire
Ballard Spahr Andrews & Ingersoll, LLP
1735 Market Street, 51st Floor
Philadelphia, Pennsylvania
Phone: (215) 864-8707
Fax: (215) 864-9890
Email: axelroth@ballardspahr.com
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APPENDIX 1 CONSTRUCTION PROJECTS AND THE NEW AIA DOCUMENTS: FROM THE OWNER'S AND LENDER'S PERSPECTIVES