New York Law Journal

Real Estate Trends

WWW.NYLJ.COM

An ALM Publication

VOLUME 252—NO. 49

WEDNESDAY, SEPTEMBER 10, 2014

CONSTRUCTION LAW

Owner's Claims For Consequential Damages

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Construction contracts—whether between owners and architects or owners and contractors—often contain mutual waivers of consequential damages; however, before agreeing to such a waiver, owners and their counsel should fully understand the nature of consequential damages and the effect of the waiver.

Damages In General

When an owner of a construction project brings an action for damages arising from a breach of duty or contract against an architect or contractor, the owner, absent a contractual limitation, may seek compensation for (1) direct and immediate costs, or loss of contract value, that naturally and usually flow from that sort of breach ("direct damages"); and for (2) such incurred costs, or economic harm, which can reasonably be said to have been in the contemplation of the parties when the contract was made ("special" or "consequential damages"). The dollar value sought as damages, e.g., repair costs, the cost of cover, lost rents, lost profits, or extended administration costs, and its components must pass the legal tests of causation, certainty, and foreseeability.[1] This is relatively straight forward with respect to direct damages. Consequential damages, however, are more difficult to establish and are subject to a higher burden of proof.[2]

In practice, the line between direct and consequential damages can only be drawn in the context of the specific facts of an individual case. Thus, for example, one form of damages, e.g., lost profits, may be found to be direct in the context of one case, and consequential in another.[3] The distinguishing characteristic in a given set of circumstances is that consequential damages do not always follow a breach of that particular character. Direct damages, which flow naturally or ordinarily from that type of a breach, compensate for the value of the promised performance.[4] Consequential damages, although not an invariable result of every breach of that kind, may nevertheless be awarded if, under the circumstances, such additional costs can reasonably be said to have been in the contemplation of the parties when the contract was made.[5] For example, where plaintiff was a business engaged in the construction and sale of new homes, a fact finder was permitted to conclude that the additional carrying, maintenance and marketing costs incurred by developer as a result of purchasers' breach of the real estate contract were both reasonably foreseeable and contemplated by the parties.[6]

Recovery of Damages

Consistent with Benjamin Franklin's "Advice to a Young Tradesman, Written by an Old One,"—"time is money"—time-related damages attributable to a contractor's "inexcusable" delay in project completion may lead to direct damages[7] or consequential damages. The latter—additional expenses due to delays—may include various costs or economic harm, such as (1) loss of use;[8] (2) additional and extended construction financing;[9] (3) substitute facilities;[10] (4) extended project administration;[11] and (5) lost profits,[12] unless waived.

Lost profits are typically the foremost among consequential damages sought by owners. Lost profits are recoverable if they: are directly traceable to the breach; are not remote or the result of other intervening causes; can be proven to a reasonable certainty; and, lastly, are not merely speculative, possible or imaginary.[13] In addition, there must be a showing that the particular damages were fairly within the contemplation of the parties to the contract at the time it was made.[14]

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Claims for lost profits arising out of delay may be found to be too speculative where the claim for delay itself is unsubstantiated.[15]

For example, in *Kenford v. County of Erie*,[16] the county failed to satisfy its commitment to negotiate a lease with the developers for the operation of a stadium and the project was abandoned. The intended operator of the stadium sued the county for the loss of prospective profits during the 20-year period of the anticipated management contract. At trial, the plaintiffs won a multimillion-dollar judgment. The intermediate appellate court modified the judgment on the ground that expert opinion did not provide a rational basis for the calculation of lost profits. The Court of Appeals, however, denied consequential damages. A plaintiff seeking lost profits, the Court of Appeals concluded, must demonstrate that the "particular damages were fairly within the contemplation of the parties to the contract at the time it was made."[17] Finding that the lost profits award was based on a speculative assessment of how much income would be generated by the never-constructed stadium, the Court of Appeals held that plaintiff's proof failed on the second prong. The court also found, based on the record before it, that lost profits damages had not been within the contemplation of the parties.

In a sequel to *Kenford*,[18] the court rejected a claim for damages by the stadium developers for the loss of anticipated appreciation in the value of land that they had purchased on the periphery of the proposed stadium site. The contract stipulated that part of the compensation paid to the county would consist of increased real property taxes resulting from the enhanced value that the peripheral land would enjoy as a result of the stadium. That clause suggested that plaintiffs expected to profit from development of the land and that breach would deny the plaintiffs those anticipated profits.[19] Nevertheless, the court denied recovery, reasoning that plaintiffs could only recover these damages if they were within the contemplation of the parties as the probable result of a breach at the time of contracting. And what was in the parties' contemplation depended on "the nature, purpose and particular circumstances of the contract known by the parties…as well as 'what liability the defendant fairly may be supposed to have assumed consciously, or to have warranted the plaintiff reasonably to suppose that it assumed, when the contract was made.'"[20] Such a fact-specific and subjective inquiry is bound to produce inconsistent results unless parties marshal evidence bearing on what they had contemplated.[21]

Lost profits are typically the foremost among consequential damages sought by owners.

A party to a contract also may recover financing costs as incidental damages, apart from prejudgment interest allowable under New York State law.[22] Generally, courts award such relief where the injured party can point to costs associated with a particular loan that was "commercially reasonable and foreseeable" under the circumstances.[23] In New York, however, claims seeking interest as part of damages rarely succeed because of the limitations on consequential damages discussed above.[24] Thus, for example, in the context of mortgage rates, unless the parties had allocated the risk of interest rate fluctuating and leading to additional costs as a result of a culpable delay in performance, courts may be reluctant to allocate such risk, and instead find that the parties had not contemplated such additional cost.[25]

Waivers

Sophisticated owners and contractors can easily anticipate most consequences likely to result from construction contract breaches. For this reason, contractors and design professionals routinely seek to obtain a waiver of consequential damages for fear that an imposition of such damages might have disastrous financial effects, particularly where there is no insurance coverage for claims of an owner. Determining the waiver's scope can be as challenging as determining what damages are "consequential"—and thus within the scope of waiver—which can vary depending upon the factual circumstances.

This distinction became more important with the adoption of the 1997 version of the American Institute of Architects (AIA) document A-201, General Conditions of the Contract for Construction.' Section 4.3.10 of the 1997 version contains a waiver by the owner and the contractor of all consequential damages. The provision states that this waiver includes:

- 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
- 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.

A waiver of consequential damages is also found in the AIA forms for

owner/architect agreements.

Waivers of this nature routinely have been broadly enforced. In *400 15th Street v. Promo-Pro*, owner's claim for delay damages was dismissed "because they constitute consequential damages" and were thus barred by the contract's waiver of consequential damages, where "a plain reading of the [contract] reveal[ed] that it applied to all 'consequential damages arising out of or relating to this contract.'"[26]

In the contractor context, a waiver may leave the owner bereft of a remedy for delayed construction in the form of lost revenue and increased carrying costs. While liquidated damages may substitute for consequential damages (to the extent they approximate delay damages suffered), contractors are equally loath to agree to assume that obligation. An alternative approach may be simply to limit the amount of consequential or liquidated damages recoverable to a tolerable range. Consideration should also be given to restricting the waiver to first party claims between the owner and contractor, which are not covered by general liability insurance.

However, there should be no waiver of consequential damages arising from a third-party action against an owner arising from negligence or breach of contract by the contractor because such claims are generally covered by the contractor's general liability insurance. Additionally, where a non-party to a construction contract brings allegations sounding only in tort, absent contractual rights and privity, recovery is permitted only for losses from tortious invasion that cause personal injury or property damage to plaintiff. [27]

The calculus with respect to design professionals is a bit different. Unlike contractors carrying only general liability insurance (which, as noted, does not provide coverage for first-party claims), architects also carry professional liability insurance, which will cover claims for consequential damages by an owner against an architect. A reasonable balance may be to limit the architect's liability for consequential damages to the amount of insurance being carried. Owners, however, should proceed cautiously, for the architect's insurance coverage may be eroded by multiples claims.

While waivers are common place and broadly enforced, the full ramification of the waiver should be understood as possibly leaving an aggrieved owner without a complete remedy for damages flowing from the breach.

Conclusion

Under appropriate circumstances, consequential damages for breach of construction contracts are recoverable if foreseeable in nature and not waived. While waivers are common place and broadly enforced, the full ramification of the waiver should be understood as possibly leaving an aggrieved owner without a complete remedy for damages flowing from the breach. Thus, care should be taken in agreeing to the waiver and negotiating its full terms.

1. See, e.g., *Glens Falls Ins. v. Quality Furniture*, 301 A.D.2d 626, 754 N.Y.S.2d 346, 347 (2003).

2. See, e.g., *Compania Embotelladora Del Pacifico, S.A. v. Pepsi*, 650 F. Supp. 2d 314, 322 (S.D.N.Y. 2009) (addressing whether the breach of contract damages sought by the plaintiff "are general, thus merely requiring a "reasonable estimate' of damages before an award can be made, or instead consequential, thus requiring CEPSA to prove such damages 'with reasonable certainty"').

3. Compare *Am. List Corp. v. U.S. News & World Report*, 75 N.Y.2d 38, 42 (1989) (lost profits are direct damages), with *Kenford v. County. of Erie*, 73 N.Y.2d 312, 321 (1989) (loss of anticipated profits and loss of anticipated appreciation in value of land owned in periphery of proposed stadium site are consequential damages).

4. *Latham Land I, v. TGI Friday's*, 96 A.D.3d 1327, 1330-31 (2012).

5. *Am. Standard v. Schectman*, 80 A.D.2d 318, 321 (1981).

6. See, e.g., *David Home Builders v. Misiak*, 937 N.Y.S.2d 524, 525 (2012) (for the purchasers' breach of contract, the jury properly awarded the vendor consequential damages).

7. *Lake Steel Erection v. Egan*, 403 N.Y.S.2d 387, 389 (1978) (lost profits for delay in grouting the concrete flooring slabs).

8. Cf. e.g., *Cooperstein v. Patrician Estates*, 499 N.Y.S.2d 423, 424 (1986) (for breach of contract for construction and sale of house, home purchasers were entitled to award of damages to compensate them for contractors' breach of promise to timely construct house on premises).

9. Cf. e.g., *Bulk Oil (U.S.A.) v. Sun Oil Trading*, 697 F.2d 481, 482 (2d Cir. 1983) (citing *Neri v. Retail Marine Corp.*, 30 N.Y.2d 393, 397 (1972)); *Long Island Lighting v. IMO Indus.*, 85 CIV. 6892 RO, 1990 WL 64588 (S.D.N.Y. May 3, 1990) ("a party to a contract may recover financing costs as incidental damages, apart from prejudgment interest allowable under New York State law.").

10. Cf., e.g., *Losei Realty v. City of New York*, 254 N.Y. 41, 47 (1930) (landowner could recover, as damages resulting from city's delay in filling in property, loss in rental value resulting from the period of delay reasonably attributable to city).

11. Cf., e.g., *Manshul Const. v. Dormitory Auth. of New York*, 436 N.Y.S.2d 724, 729 (1981).

12. See *Ansonia Brass & Copper v. Gerlach*, 8 Misc. 256, 259-60, 28 N.Y.S. 546, 549 (Com. Pl. 1894).

13. *Kenford v. Erie County*, 67 N.Y.2d 257, 261 (1986).

14. Id.

15. *Teramo & Co. v. O'Brien-Sheipe Funeral Home*, 725 N.Y.S.2d 87, 90 (2d Dept. 2001) (trial court erred in awarding profits lost due to construction delay; owner's unsubstantiated claim that it lost business due to the delay in completing construction of the extension to its funeral home was too speculative to allow recovery).

16. 67 N.Y.2d 257, 261 (1986).

17. Id.

18. *Kenford v. Erie County*, 73 N.Y.2d 312, 315 (1989).

19. Id. at 317-18.

20. Id. at 319 (quoting *Globe Ref. v. Landa Cotton Oil*, 190 U.S. 540, 544 (1902)).

21. *Route 7 Mobil v. Machnick Builders*, 296 A.D.2d 809, 810 (3d Dept. 2002) (rejecting a gas station owner's claim for four years of lost profits attributable to water contamination of an underground diesel fuel tank allegedly improperly installed by the contractor based on finding that owner failed to offer adequate proof to meet any of the required elements of direct or consequential damages).

22. See cases cited, supra, note 9.

23. Id.

24. See, e.g., *Ernst Steel v. Horn Const*, 104 A.D.2d 55, 63 (1984) amended, 109 A.D.2d 1104 (1985) (manufacturer failed to substantiate its claim that the entire amount of increased costs due to the delay was paid for with borrowed funds).

25. See *Hurley v. Watanabe*, 2014 N.Y. Slip Op. 32160(U), 2014 WL 3870614, at *10 (N.Y. Sup. Aug. 5, 2014) (finding that parties agreement indicated that risk for an interest rate was not allocated, and in light of the time allotted for performance, placing such risk on defendant is not warranted).

26. *400 15th Street v. Promo-Pro*, 28 Misc. 3d 1233(A), 2010 WL 3529466, at *10 (N.Y. Sup. 2010) (dismissing claims for consequential damages for losses due to the change in the Zoning Resolution, consisting of delay damages, attorney fees to appeal the zoning change, and its payment of additional interest, insurance, and other carrying charges."); see also *New York Trans Harbor v. Derecktor Shipyards Conn.*, 15 Misc. 3d 1140(A), 2007 WL 1532293, at * 6 (Sup. Ct. 2007) (enforcing waiver of consequential damages with respect to delay damages).

27. *5th Ave. Chocolatiere v. 540 Acquisition*, 712 N.Y.S.2d 8 (1st Dept. 2000), rev'd, 96 N.Y.2d 280, 294 (2001) (reversing lower court's allowance of recovery for economic loss, holding that negligence claims seeking recovery of purely economic loss fell beyond the scope of duty owed by reason of city's closure of streets for safety reasons to businesses impacted and area residents evacuated from their homes); *Amin Realty v. K & R Const.,* 306 A.D.2d 230, 231 (2d Dept. 2003) (denying a building owner's negligence claim against a concrete supplier under the economic loss doctrine, and ruling that the owner did not fall within the third-party beneficiary exception because "the record is devoid of any evidence that the parties intended that the [building owner] be a beneficiary of the contract. The [owner], at most, was an incidental beneficiary of such contract."); *Bri-Den Const. v. Kapell & Kostow Architects,* 56 A.D.3d 355, 355 (1st Dept. 2008) (stating the rule that economic losses could be recovered in a relationship that was the "functional equivalent of contractual privity," but rejecting the claim of a contractor against an architect after finding no such privity).