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CONSTRUCTION LAW

Owners Should Take Caution in Waiving Consequential Damages



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It is common in most construction contracts for there to be a mutual waiver of consequential damages. Owners, however, should take caution before agreeing to provide a broad unqualified waiver to contractors.

Generally speaking, consequential damages in construction contracts relate to indirect losses or damages incurred by either the owner or contractor arising from a breach by the other, such as lost income or increased financing costs on the part of the owner or loss of business opportunities by the contractor. In both situations, the consequential damages incurred by the non-defaulting party may be difficult to ascertain and may be excessive in the context of the overall value of the contract at issue. This can be contrasted with direct damages, such as the cost



to correct or complete the work by the owner or the loss of profits on the work by the contractor.

From the owner's perspective, a blanket waiver of consequential damages, such as that contained in various American Institute of Architects (AIA) documents is problematic on two levels. First, the waiver will deprive the owner of a remedy for the financial losses it will suffer if, for example, the project is delayed by the

contractor and the owner loses sales or rental income.

However, because of the catastrophic losses an owner may incur as a result of delayed completion, contractors will, as a matter of course, demand the waiver and, perhaps, offer in its place liquidated damages designed to limit the amount of damages the owner may recover. (Liquidated damages must, however, bear some relationship to the actual damages

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the owner will suffer for delay, otherwise they would be considered an unenforceable penalty.)

Second, a blanket waiver may impede the ability of the owner to be indemnified for claims of third parties seeking consequential damages against the owner resulting from the activities of the contractor, such as neighbors who may have suffered property damage or interference with their businesses. This implicates the contractor's indemnification of the owner and brings a slight detour in our discussion.

Traditional indemnities in favor of the owner, including those found in AIA documents, deal, essentially, with personal injury, bodily injury and property damage. They do not include indemnification for claims of third parties seeking monetary damages, such as unpaid subcontractors, neighbors, or civil authorities. Because of this, we have included in our construction contracts indemnities of owners for third-party claims against the owner for economic loss. While, invariably, there is objection to this expansion of the traditional indemnity by contractor counsel, once it is explained that we are only looking for protection against third-party claims for damages arising from the contractor's negligence or breach of contract, the expansion is generally accepted.

This brings us back to our discussion of consequential damages and the breadth of the waiver. If a blanket waiver is given, arguably, the indemnity for claims of third parties may be lost, inasmuch as a claim by a third party may be considered consequential damages. In order to remedy this possibility, in our construction contracts, we first carve out from the waiver any claims of third parties. We also address other circumstances for which a waiver of consequential

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damages would not be appropriate, such as where the contractor is guilty of gross negligence or willful misconduct; insurance is available to the contractor for the owner's claim for consequential damages; or it arises from defective or nonconforming work. The latter point covers situations where, for example, the owner suffers a loss of income due to repairs necessitated by defective work, such as the closing of a retail establishment while remedial work is being performed.

The language we have crafted addressing these carve outs is as follows:

Contractor and Owner waive Claims against each other for consequential damages arising out of or relating to this Agreement, other than with respect to (a) claims of third parties against Owner, (b) claims that arise due to Contractor's and/or Subcontractors' gross negligence and/or willful misconduct, or (c) claims by Owner for consequential damages against Contractor that are covered by insurance or arise from defective and nonconforming Work.

While on the topic of consequential damages, we should close by noting that, as to design professionals, we do not believe there should be *any* waiver of consequential damages by an owner, for the simple reason that professional liability policies generally cover architects and engineers for all damages arising from errors and omissions, regardless of the characterization of such damages as direct or consequential. While, as with contractor counsel, there is initial push back from counsel for design professionals on this point, once it is explained that insurance is available, the demand for the waiver is usually dropped.