

Consequential Damages –Waiving Them May be of No Consequence

Rick Reed
Director
Coats Rose, P.C.

Consequential damages are a serious concern. Consequential damages differ from "direct" or "actual" damages that flow naturally and necessarily from a breach of contract. Examples of direct or actual damages include costs to correct defective work or finish a defaulting contractor's work. Consequential damages are remote, result indirectly from a breach, and are not contemplated by the parties when the contract is signed. Consequential damages are generally thought to include things such as loss of future revenue or profits that might be derived when the project is completed, loss of business opportunity, and the cost of unknown financing or interest charges that may arise from delay of the project.

Consequential damages can be enormous. Unless expressly waived, consequential damage liability silently lurks in every construction contract. Parties often agree to waive each others' liability for consequential damages because such damages are, by their nature, difficult to anticipate and unpredictable. They can cause the risk assumed in relation to the contract price to become unreasonable.

Owners may agree to waive or set a daily liquidated damages rate to limit the contractor's liability for consequential damages. Owners may obtain or already have business interruption or delay-in-opening insurance for lost revenue due to accident or a delay disrupting the flow of revenue. Standard AIA contract forms include reciprocal waivers of consequential damages.

In the recent case of *Tennessee Gas Pipeline Company vs. Technip* a contractor was more than a year late completing a pipeline project. The contract included a typical consequential damages waiver. The court examined several of the owner's claims for damages due to delay; the owner's claims included loss of use of funds spent on the project during the period of delay, inefficiency costs the project was expected to eliminate, costs incurred to pay a minimum power purchase commitment, and loss of the value of gas the owner had to vent to the atmosphere as a result of workmanship problems. These claims amounted to many millions of dollars, but the court found them to all be indirect, not within the contemplation of the parties, and therefore consequential. *However*, the court allowed the owner to recover its cost increases due to delay where the

contract described the owner's intent to pay such costs during the project. For example, because the contract provided the owner was expressly responsible for providing power to the project, the court said that such cost "can be conclusively presumed to have been foreseen or contemplated by [the contractor] and that, as a consequence of [contractor's] breach . . . [the owner] would have to continue paying these ongoing costs."

Lesson learned: a consequential damages waiver clause doesn't eliminate liability for all indirect damages. A contract may describe certain indirect costs the owner will incur, and this can put such costs squarely within the contemplation of the parties. Owners may want to take advantage of this approach in drafting their contracts. Contractors will want to watch for and consider quantifying or limiting liability for owner indirect costs described in the contract, and not rely upon a consequential damages waiver.

Richard L. Reed is a Director in the law firm of Coats, Rose, Yale, Ryman & Lee, P.C., which concentrates its practice in construction law and real estate. Rick is a past Chair of the Texas State Bar Construction Law Section and is a frequent speaker on construction law issues. Rick's experience includes handling complex construction disputes, developing strategies for the formation of business entities, and drafting and negotiating complex construction contracts. See www.coatsrose.com for more information about Rick and his law firm.