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CONSTRUCTION LAW

Can Consequential Damages Be Waived Mutually?

No Connecticut cases on point with regard to bad faith exception

By RICHARD C. ROBINSON

The latest version of the American Institute of Architects (AIA) General Conditions contains a provision in which the contractor and owner mutually waive their rights to consequential damages against the other. AIA 201 1997 General Conditions § 4.3.10.

Viewed from the contractor's perspective, the provision anticipates that the contractor might fail to perform or misperform in some fashion and thus become liable to the owner for breach of contract. The provision limits the owner's recoverable damages to direct damages, that is to those damages reflecting "the loss in value [to the owner] of the [contractor's] performance caused by [the] failure or deficiency [of the contractor's performance]. *Ambrogio v. Beaver Road Associates*, 267 Conn. 148, 155 (2003) (citing 3 Restatement Contracts § 347(a) (1981)).

The provision eliminates liability for consequential damages; that is for losses "that 'may fairly and reasonably be considered [as] arising naturally, i.e., according to the usual course of things from such breach of contract itself.' " *Id.*, quoting from *West Haven Sound Development Corp. v. West Haven*, 201 Conn. 305, 319 (1986) (quoting *Hadley v. Baxendale*, 9 Ex. 341, 354, 156 Eng. Rep. 145 (1854)). The pertinent AIA section specifies some of the consequential damages the owner is waiving. The list includes damages for rental expenses, loss of use, lost income, lost profits, extended financing expenses and damage to reputation.

An owner's consequential damages can conceivably be huge and grossly disproportionate to the contractor's profit. In *Perini Corporation v. Great Bay Hotel & Casino*, 129 N.J. 479, 610 A.2d 364 (1992), the plaintiff, Perini, was a construction manager on a project to partially renovate the defendant's large hotel and casino in Atlantic City. Perini's duties included supervising the various trade contractors, guaranteeing a maximum price and achieving completion by May 31, 1984. Perini failed to complete by May 31, 1984, but all that remained at that point was the installation of a $400,000 ornamental, non-functional glass façade. Significantly, the hotel and casino were continuously in operation throughout the work. By September 1984, Perini finished the façade and reached completion. The defendant, nevertheless, asserted a lost profits claim against Perini, an arbitration panel awarded it $14,500,000, and the New Jersey courts upheld the award. Perini's fee on this job was only $600,000! Based on Perini, and other similar cases, the Associated General Contractors of America lobbied successfully for the mutual waiver of consequential damages provision in the current AIA General Conditions.

Exception Swallows Rule

One would think that contractors could now rest easy knowing that their liabilities on a job could no longer be disproportionate to their profits on that job. Think again. Even though the mutual waiver language in the General Conditions is clear, unambiguous and includes no exceptions, owners' counsel are arguing for a common law exception, and as a practical matter, the exception for which they are arguing could potentially swallow the rule. Their claim is that court should not enforce the clauses limiting the recovery of consequential damages, if the contractor's performance was in bad faith.

There is some support for such an argument. In *Union Carbide Corporation v.*

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Siemens Westinghouse Power Corporation, 2001 U.S. Dist. LEXIS 19216 at p. 3, the Southern District of New York acknowledged that clauses limiting the recovery of consequential damages are valid and enforceable under Connecticut law, but further observed that these clauses may be disregarded if the party seeking to enforce them acted in bad faith. The authority cited for the proposition that this is Connecticut law is *International Connectors Indus. Ltd v. Litton Sys. Inc.,* 1995 U.S. Dist. LEXIS 5769, a Connecticut District Court case.

Yet, in that case, the court merely concluded that there was support in "the case law" for such a position. And the "case law" to which the court was referring comprised two federal cases applying New York law. *Long Island Lighting Co. v. Transamerica Delaval*, Inc., 646 F. Supp. 1442, 1458-59 (S.D.N.Y. 1986) ("A defendant may be estopped from asserting a contractual limitation of consequential damages if the defendant has acted in bad faith."); and *County Asphalt Inc. v. Lewis Welding Engineering Corp.*, 323 F. Supp. 1300, 1308 (S.D.N.Y. 1970) ("Were the defendant guilty of bad faith, it might have been *estopped* from asserting exculpatory contractual language."). Suffice it to say, neither these New York cases, nor the Connecticut District Court's *International Connectors* case creates Connecticut law.

No Connecticut Cases

The fact is that there are no Connecticut cases on point. Owner's counsel, nevertheless, make two arguments to demonstrate that the so-called bad faith exception is indeed Connecticut law. First, they argue that the waiver of consequential damages is analogous to a no-damage for delay clause, and that the Connecticut Supreme Court has ruled that a contractor cannot enforce a no-damage for delay clause if its bad faith or willful, malicious or grossly negligent conduct caused the delay. *White Oak Corp. v. Department of Transportation*, 217 Conn. 281, 289 (1991).

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A no-damage for delay clause, however, eliminates all damages for one type of violation. A wavier of consequential damages clause merely limits the damages available for violations. Arguably, the two clauses are insufficiently similar to warrant similar treatment.

Second, owner's counsel argue that exculpatory clauses are disfavored under Connecticut law. However, the cases they cite involve clauses that free their beneficiaries from liability. The waiver clause here merely frees its beneficiaries from a single category of damages. There is no basis for asserting that Connecticut law disfavors contractual limitations on damages. Indeed, the Uniform Commercial Code expressly sanctions consequential damages exclusions unless they are unconscionable. C.G.S. § 42a-2-719.

As we noted at the outset, the consequential damage waiver here reflects the parties' agreement on the consequences that could befall one of them if the other breached, no matter how they happened to breach or their state of mind in breaching. It would be odd indeed if the court or an arbitrator could disregard this agreement simply because the breach reflected a particular level of culpability. ■