May 2021

BUILDING BLOCKS

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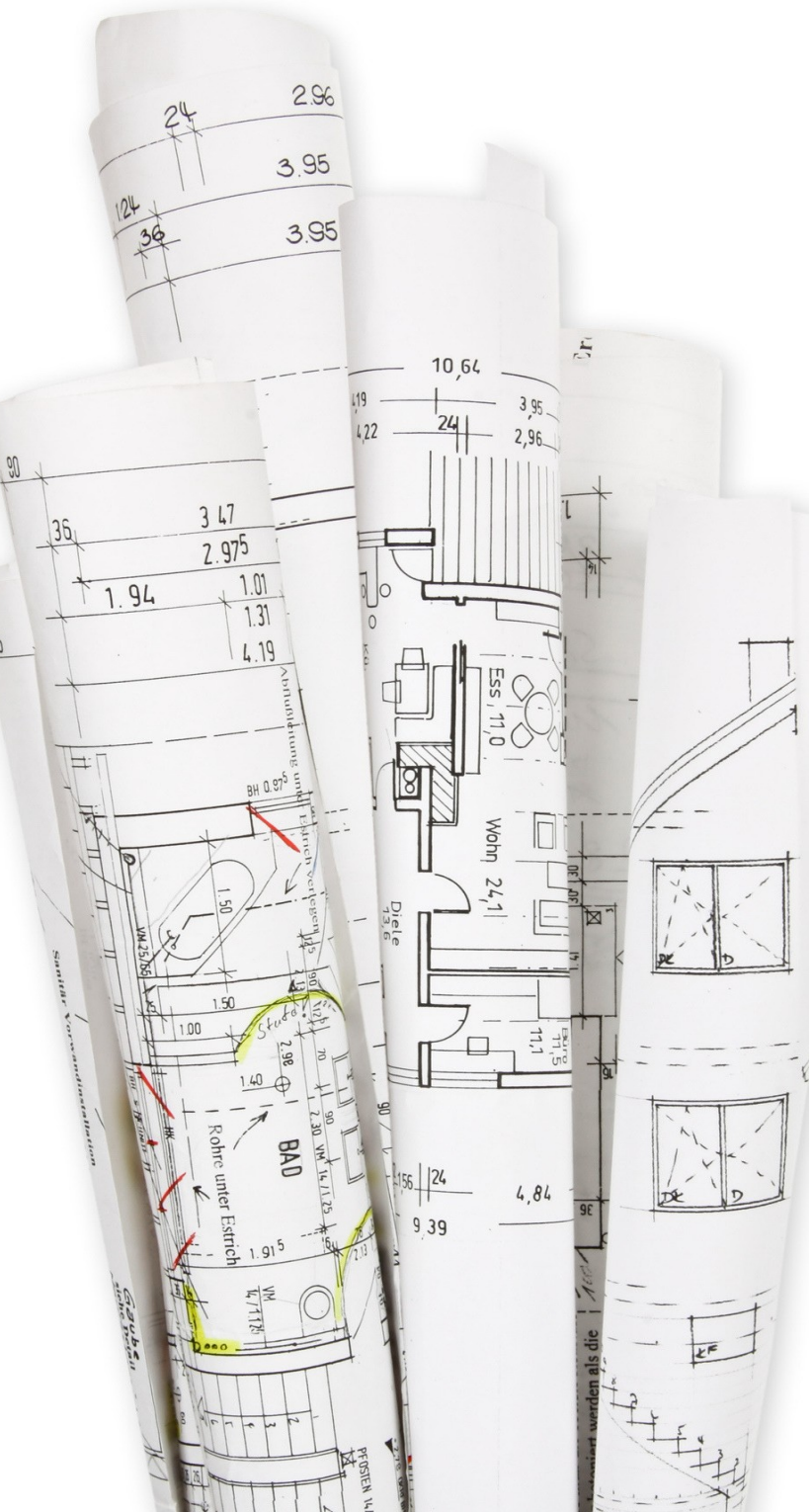

WAIVER OF CONSEQUENTIAL DAMAGES:
WHY IT IS SO IMPORTANT TO ARCHITECTS & ENGINEERS

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Consequential damages, otherwise known as special damages, are damages that flow from and can be proven to have occurred because of the failure of one party to meet its obligations in a contract. Examples include:

- Loss of anticipated profits by one of the two parties to an agreement;
- Loss of business by one of the two parties to an agreement;
- Cost of unsuccessful attempts to repair defective goods by one of the two parties to an agreement;
- Loss of goodwill by one of the two parties to an agreement;
- Losses resulting from interruption of buyer's production process by one of the two parties to an agreement;
- Loss of reputation by one of the two parties to an agreement; and
- Loss of sales contracts because of delayed products by one of the two parties to an agreement.

IN THIS ISSUE:

Architects and engineers are particularly advised to include a “waiver of consequential damages” in their agreements with their clients. Here is why, but let’s first go back in time to 1854, in merry old England. The landmark case of Hadley v. Baxendale established a limitation on the compensatory rule with regard to one party’s failure in a contractual relationship.

> We think the proper rule in such a case as the present is this: where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such ‘failure to perform’ should be such as may fairly and reasonably be considered either arising natural, i.e. according to the usual course of things from such ‘failure to perform’ in the contract itself (let’s call this “direct damages”), or such as may reasonably be supposed to have been in the contemplation of both parties at the time they made the contract, as the probable result of a ‘failure to perform’ (let’s call this “consequential damages”). Exchequer Court, Judge Baron Alderson. Parenthetical language added.

What every student learned in law school, was the establishment of the rule of law to determine if consequential damages from an alleged failure by either party is appropriate: a party is liable for all losses that the contracting parties should have foreseen, but is not liable for any losses that the other party could not have foreseen with the information available to him or her.

Appellate Judges Baron Alderson, Lord Chief Justice Campbell, Justice Cresswell

https://commons.wikimedia.org/wiki/File:Anales_dram%C3%A1ticos_del_crimen,_1858_%22Envenenamiento_de_John_Parsons%22_(6962841358).jpg

THE CASE OF HADLEY V. BAXENDALE FACTS, ISSUE, HOLDING

FACTS IN THE CASE: Hadley was the owner a grist mill, which was forced to shut down when its steam engine crank shaft broke. Hadley went to Baxendale’s office, to hire him, to have the crank delivered that was to be fabricated by another company. Hadley informed Baxendale that the mill was shut down, and the shaft must be sent immediately. Baxendale told Hadley that if the shaft was not able to be delivered by twelve noon when a new shaft could be delivered, it would be delivered by the next day. Due to Baxendale’s delay, Hadley did not receive the new shaft for several days.

ISSUE IN THE CASE: Is Baxendale liable to Hadley for monetary damages suffered by Hadley due to lost profits when the mill was shut down?

HOLDING: The jury awarded Hadley £25 (between 1850 and 2017 a single £1 would have a cumulative price increase of 12,700%). Baxendale appealed, contending that he did not know that Hadley would suffer any particular damage by reason of late delivery. The appellate court held that a party is entitled damages arising naturally from the failure to perform by the other party, or those that are in the reasonable contemplation of the parties at the time of contracting.

Here, while the failure to perform by Baxendale was the actual cause of the Hadley’s lost profits, it cannot be said that under ordinary circumstances such loss arises naturally from this type of case. Baxendale had no way of knowing that his delayed delivery would cause a longer shutdown of the mill, resulting in lost profits. Further, Hadley never communicated the special circumstances to Baxendale, nor did he know the

special conditions. Damages are limited to those that arise naturally from a failure to perform, and those that are reasonably contemplated by the parties at the time of contracting. The jury award was reversed.

AS APPLIED TO ARCHITECTS & ENGINEERS

In a particular project, an A/E may not know the amount of special damages that could flow from their failure to meet the obligations to their client. Damages could include a client's loss profits from a retail store because of an A/E's alleged negligent error or omission, a structural engineering design failure, or lost rental income from an office building because the client's program was not met. And a client could sue their A/E totally out of proportion to the professional fee involved, eclipsing the actual cost of remedying or repairing any damage many times fold.

This rule of law is so recognized in our country's jurisprudence, that it has been memorialized in design professional standard forms of agreements. The Engineers Joint Contract Document Committee, Agreement Between Owner & Engineer for Professional Services, E-500 (2014), Article 6.11 F., states that:

> **6.11 F. Mutual Waiver**: To the fullest extent permitted by Laws and Regulations, Owner and Engineer waive against each other, and the other's employees, officers, directors, members, agents, insurers, partners, and consultants, any and all claims for or entitlement to special, incidental, indirect, or consequential damages arising out of, resulting from, or in any way related to this Agreement or the Project, from any cause or causes.

Likewise, the American Institute of Architects' Standard Form of Agreement Between Owner & Architect, B101 (2017), states that:

> **§ 8.1.3** The Architect and Owner waive consequential damages for claims, disputes, or other matters in question, arising out of or relating to this Agreement. This mutual waiver is applicable, without limitation, to all consequential damages due to either party's termination of this Agreement.

While it makes sense that an A/E's client should waive claims for consequential damages for failure to perform, in all fairness, the design professional should also waive any claims for consequential damages. That is why the professional association agreements are structured as a mutual promise to waive these claims for damages from each other, so that the client's acceptance would be more likely.

Unfortunately, many A/Es' clients object to a waiver of consequential damages clause in an agreement, deleting the provision in a proposed a professional association agreement. Or, the A/E may be presented with a client-driven agreement that makes the design professional responsible for consequential damages, such as in an indemnification clause. One thing to be clear, is that a waiver of consequential damage clause applies between the design professional and their client, and not to third parties. This is because the clause is a creature of contract, and does not extend to claims from end-users of an A/E's projects.

https://www.latestlaws.com/latest-news/nation-s-international-law-obligations-and-vision-of-social-equality-sc-asks-to-calculate-notional-income-of-homemakers-on-work-sacrifices/

IN CONCLUSION, PROFESSIONAL LIABILITY INSURANCE CARRIERS LIKE THIS RULE OF LAW TOO

When a design professional's clients waive claims for consequential damages, the A/E's professional liability insurance carrier will also realize a benefit as well. The carriers know that their insureds' clients' allegations, if proven, may dramatically increase the damages that would have to be paid-out to resolve a lawsuit. That could increase their insureds' loss history, and potential renewal costs of their professional liability insurance policy.

About the Author

Eric O. Pempus, FAIA, Esq., NCARB has been a risk manager for more than 15 years with experience in architecture, law and professional liability insurance, and a unique and well-rounded background in the construction industry. He has 25 years of experience in the practice of architecture, and as an adjunct professor teaching professional practice courses at the undergraduate and graduate levels for the last 34 years. As a Fellow of the American Institute of Architects and Chair/Hearing Officer of the AIA National Ethics Council, he has demonstrated his impact on architectural profession. He has presented numerous loss prevention and continuing educational programs to design professionals and architectural students in various venues across the United States and Canada.

MARK YOUR CALENDARS FOR ERIC'S UPCOMING CONTINUING EDUCATION PROGRAMS:

Speaking Engagements:

"Ethically Looking Outward – Architecture/Interior Design Perspectives"
The Alberta Association of Architects,
Banff Alberta, Canada
Virtual Kickoff event on April 23, 2021 followed by a month of professional development (PD) presentations from April 24, 2021 to May 24, 2021.

"What You May Have Forgotten From the "01" Family of AIA Documents" AIA B101, C401, A201, A101
AIA Cleveland Webinar, 1 LU
May 20, 2021 – 12:00 pm – 1:00 pm

"Ohio Engineering Law & Ethics"
Virtual Presentation
7.5 CPD for Engineers – Includes 2.0 Ethics
June 21, 2021 – 8:30 am – 4:30 pm

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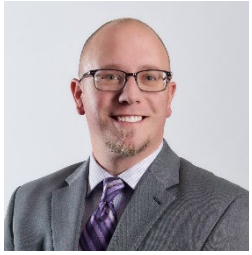

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