

# Is the AIA's Mutual Waiver of Consequential Damages Really Mutual?

Article By:

Brent T. Johnson

---

Imagine you are the general contractor on a \$24 million hotel-casino expansion project. Your company is not performing any actual construction on the job, and your total compensation is only \$600,000. You know that this hotel-casino will be extremely profitable when completed, and as with any project, you know the owner demands timely completion. At your direction the project is substantially completed on time, with the exception of a non-functional, ornamental facade designed to attract passerbys from the boardwalk. The owner sues you for damages resulting from the delay with the facade, and an arbitrator awards the owner consequential damages of \$14,500,000 for lost profits. You not only lose all of your compensation, but are responsible for paying over 24 times your planned gross revenue on the job.

Does this sound unbelievable? Certainly inequitable. But this is a real case, *Perini Corp. v. Great Bay Hotel*, and the New Jersey appellate court upheld the consequential damages award on appeal. In response to this case and similar results across the country, in October 1997, the American Institute of Architects (AIA) adopted substantial revisions to its Owner/Architect Agreement (B141) and the General Conditions (A201) to its Owner/Contractor Agreement. One major revision is the addition of a mutual waiver of consequential damages provision to the General Conditions, A201 at § 4.3.10. The AIA included this provision at the urging of the Associated General Contractors of America (AGC) to address the gross inequities of the ever expanding awards of consequential damages against contractors. By eliminating consequential damages, it is the intent of the new AIA form to ensure that the risk taken by a contractor is proportional to the contractor's compensation on the project.

This article identifies the major issues raised with the elimination of consequential damages in an owner/contractor agreement, and provides pointers to best deal with the revised AIA documents and its waiver of consequential damages.

## The AIA to the Rescue

In response to the gross inequities caused by the ever-expanding application of consequential damages, the AIA adopted a mutual waiver of consequential damages. Recognizing that courts will not typically enforce single line or boilerplate waivers of consequential damages, the revised AIA documents specifically waive the following consequential damages:

---

## Contractor's consequential Owner's consequential

- (a) Home office overhead (a) loss of use
- (b) Lost profits (b) lost profits
- (c) Bonding capacity (c) diminution in value
- (d) Professional reputation (d) lost rent

The revised AIA forms also re-define liquidated damages, as "liquidated direct damages," to remove consequential damages from a liquidated damages award. By limiting contractual damages to general or direct damages, the AIA seeks to level the risks between the owner and the contractor, so that a contractor's potential damages are proportional with its compensation under the contract. Some owners may realize, however, that the AIA documents go too far.

### **Is the mutual release, really mutual, or did the AIA go too far?**

The AIA revisions have yet to be tested, but it appears that the mutual release of consequential damages is not really mutual at all.<sup>1</sup> The following comparison illustrates how the contractor benefits from this mutual waiver:

1. Waiver of lost profits. The contractor wins. Lost profits can be difficult for a contractor to prove, so the contractor is not giving up much. More importantly, as the Perini case illustrates, lost profits can be the largest category for the owner. The gross inequities in awards of lost profits against contractors was the primary focus of the AIA in adopting the waiver of consequential damages.

2. Home office overhead v. loss of use: The contractor wins. Most states limit the contractor's ability to prove home office overhead, so again, the contractor does not give up that much. On the other hand, loss of use can be powerful leverage for owners when negotiating settlements. Thus, contractors sacrifice little, while owners lose one of their best bargaining chips.

3. Liquidated "direct" damages: The contractor may win. The revised AIA forms re-define liquidated damages as "liquidated direct damages." By redefining liquidated damages, the AIA intended to remove consequential damages from a liquidated damages award. However, there really is not such thing as liquidated "direct" damages. Liquidated damages are indirect, consequential damages which cannot be calculated at the time the parties enter the contract. If damages are direct, i.e., readily ascertainable at the time of contract, then by definition, they do not qualify as liquidated damages. By limiting liquidated damages as only liquidated "direct" damages, all liquidated damages may be eliminated. In theory, therefore, the removal of consequential damages from liquidated damages would prevent an owner from recovering liquidated damages at all.

### **Where do we go from here...**

Until we know the actual effect and interpretation of the waiver of consequential damages, there are creative ways to gain an advantage using the AIA forms.

1. Owners should draft creative liquidated damages clauses to include the specific consequential damages waived in the new AIA contract. As discussed above, owners should be cautious of the AIA's limitation of "liquidated direct damages," which by definition, may eliminate liquidated damages.

Thus, owners may want to delete the "direct" limitation, or add language including consequentials waived in the new contract.

2. Contractors should analyze their accounting systems, and consider re-characterizing some costs. For instance, all direct costs are general damages. Home office overhead is a consequential damage, which the contractor waives under the new AIA contract. Contractors should consider modifying their accounting systems to re-allocate as many home office charges to direct project costs as possible.

3. Creative lawyering. Should a dispute arise, creative lawyering may benefit both owners and contractors, and assist the courts in interpreting the revised AIA forms. For instance, the AIA documents only waive specific consequential damages, but do not prohibit the creation of new categories of consequential damages, or the re-characterization of consequential damages as direct damages. In addition, the interpretation of what constitutes direct as opposed to indirect liquidated damages is uncertain.

The AIA's mutual waiver of consequential damages accomplishes its main objective of equaling the risk allocation between the owner and contractor. Both owners and contractors should recognize not only the significant change created by this new waiver, but that they also can take advantage of the new provision by manipulating the agreement itself, or their own internal accounting records.

1. For a more detailed comparison, see "Mutual Waiver of Consequential Damages: The Contractor's Perspective," J. William Ernststrom, Esq. and Michael F. Dehmler, Esq., printed in *AIA Contract Documents: Generation Next*, ABA copyright 1997.

Copyright © 2008 Fairfield and Woods, P.C., ALL RIGHTS RESERVED

---

National Law Review, Volume , Number 202

Source URL: <https://natlawreview.com/article/aias-mutual-waiver-consequential-damages-really-mutual>