Dispute Resolution in Construction Contracts

Prepared by:
John A. Snow
Prince Yeates & Geldzahler

LORMAN®
Published on www.lorman.com - March 2019
Dispute Resolution in Construction Contracts, ©2019 Lorman Education Services. All Rights Reserved.

INTRODUCING

Lorman's New Approach to Continuing Education

ALL-ACCESS PASS

The All-Access Pass grants you UNLIMITED access to Lorman's ever-growing library of training resources:

- ☑ **Unlimited Live Webinars** - 120 live webinars added every month
- ☑ **Unlimited OnDemand and MP3 Downloads** - Over 1,500 courses available
- ☑ **Videos -** More than 1300 available
- ☑ **Slide Decks -** More than 2300 available
- ☑ White Papers
- ☑ Reports
- ☑ Articles
- ☑ ... and much more!

Join the thousands of other pass-holders that have already trusted us for their professional development by choosing the All-Access Pass.

Get Your All-Access Pass Today!

SAVE 20%

Learn more: www.lorman.com/pass/?s=special20

Use Discount Code Q7014393 and Priority Code 18536 to receive the 20% AAP discount.

*Discount cannot be combined with any other discounts.

RISK ALLOCATION IN CONSTRUCTION CONTRACTS

Dispute Resolution

Contracts can and do provide for various types of procedures for dispute resolution. Basically there are three different but not necessarily exclusive avenues for dispute resolution, which include mediation, arbitration and litigation. Unless there is a provision in the contract that requires mediation or arbitration, neither can be compelled.

(1) Arbitration

There are various forms of arbitration. There can be arbitration proceedings with only one arbitrator or a panel of arbitrators. When there is a panel, some of the arbitrators may not be neutral, but may in fact be designated as advocates for one of the parties to the proceeding.

Arbitrations can be structured to reduce the risks to the parties of either an unacceptably high or low award. For example, the parties may agree on minimum and maximum recoveries without informing the arbitrator. Alternatively, the parties can require the arbitrator to select one of the proposals proffered by the parties without the ability to compromise or change the proposal. The arbitration does not need to be binding, but generally is.

Regardless of the form of proceeding, an arbitration proceeding generally resembles a trial in that the parties present evidence, and make arguments, for the purpose of obtaining a favorable ruling on factual and legal issues by the arbitrator. Ultimately, the arbitrator or panel of arbitrators enters findings and conclusions, and makes a decision and award.

Many states have adopted the Uniform Arbitration Act (the "Arbitration Act"), which applies to any agreement to arbitrate. An arbitration proceeding is initiated by notice as agreed between the parties or, in the absence of any agreement, notice must be given in the manner prescribed by the Arbitration Act. Issues of whether there exists an agreement to arbitrate or

whether the controversy is subject to an agreement to arbitrate is for judicial determination, but the arbitrator decides whether a condition precedent to arbitrability has been fulfilled and whether a contract containing a valid agreement to arbitrate is enforceable. In this regard, the Arbitration Act provides a procedure for the enforcement of agreements to arbitrate.

The arbitrator is selected as agreed between the parties, or absent an agreement, by the court on motion. Once designated, but prior to acceptance, a proposed arbitrator has a duty, which continues after the appointment to act as the arbitrator, to disclose all information likely to affect the impartiality of the arbitrator.

Generally, once the arbitrator is selected, any provisional remedies, such as injunctions, can be issued by the arbitrator; prior to the commencement of an arbitration, a court is permitted to enter provisional remedies to protect the arbitration process.

The arbitrator is to conduct the arbitration process in a manner the arbitrator deems appropriate for a fair and expeditious proceeding. The arbitrator has authority over the pre-arbitration discovery procedure, which includes the issuance of subpoenas and permitting discovery. Under legally appropriate circumstances, the arbitrator may award fees, punitive damages and other appropriate remedy, including a remedy that may not otherwise be permitted in a court proceeding. The arbitration award can be confirmed by the court on motion or a judgment issued on the award, which can include fees if the award is contested. Generally, if the arbitration is binding, there is only limited review or appeal of the arbitrator's decision.

Although the arbitration process is generally less formal than trial, an arbitration is still trial-like, with the same issues of presentation of arguments, witnesses and documents. The differences between trial and arbitration are primarily procedural, and the arbitrator has greater discretion on discovery. There is less compliance with evidentiary rules, fewer pre-hearing

motions, and no jury. Arbitration should proceed more quickly, and can, therefore, be less expensive and less time consuming. Arbitrators may have a special expertise which can expedite the process and make the process more meaningful.[1]

(2) Mediation

The mediation process involves a neutral mediator, and allows the parties to openly communicate in a somewhat non-adversary environment.[2] However, the mediator does not make any binding decisions, as does a judge or arbitrator. The mediator facilitates discussion between the parties to obtain a settlement or resolution that the parties reach mutually. The mediator may give opinions and theories on the case, and may share the mediator's experience in the type of case. The mediator may suggest potential resolutions, but the parties are free to fashion their own settlement.

The mediation process is not a trial, although the mediator may have the parties present their respective positions. However, generally no evidence or witnesses are proffered, and there are no motions. The mediation is not binding unless an agreement is reached. The mediation process is generally confidential. In this regard, Federal Rule of Evidence 408 specifically excludes from evidence certain disclosures made during settlement discussions, which includes mediation.[3]

---

[1] For a discussion of the Uniform Arbitration Act, see S. Owen Griffin, Kelli Hopkins, Scot L. Wiggins, Emily Woodward, "Recent Developments: The Uniform Arbitration Act," 2000 J. Disp. Resol. 459 (2000).

[2] There is some debate as to the roll of the attorney in a mediation setting. Some pundits believe that attorneys bring an advocacy attitude to a mediation which should be avoided. *Jean R. Sternlight*, Lawyers' Representation of Clients in Mediation, 14 Ohio St. J. on Disp. Resol. 269, 274, 279 (1999). However, there are views that the attorney should act as an advocate. *Id.* at 283.

[3] Rule 408 states:

There are various factors that can justify or even compel a decision to mediate, arbitrate or litigate a dispute, or mediate a dispute before proceeding with arbitration or litigation. One factor to consider is the opposing counsel. If the legal opponent is not well trained in trial advocacy, avoiding a mediation or arbitration and proceeding directly to litigation may be warranted. Alternatively, if the opponent is a qualified trial lawyer, there is no loss of advantage by a least mediating or arbitrating where the rules are generally less strict.

Unless both parties are motivated to attempt settlement, a mediation may be of little value, unless the mediator is able to control the parties. Before engaging in mediation, there needs to be some assurance that the parties are acting in good faith towards resolution.

Available mediators and arbitrators is a further component of the decision. If the parties can agree on a qualified mediator or arbitrator, the process will be more beneficial. However, if the parties are unable to agree on a qualified mediator or arbitrator, the process will not be as productive.

Mediation is obviously less expensive and can more likely preserve a business relationship that the parties intend to retain. In *Comment,* One Trillion Dollars? An Analysis of Y2K Employment Implications for Attorney, 1999 B.Y.U.L. Rev. 1529, 1561-1562 (1999) it was noted:

> Evidence of (1) furnishing or offering or promising to furnish, or (2) accepting or offering or promising to accept, a valuable consideration in compromising or attempting to compromise a claim which was disputed as to either validity or amount, is not admissible to prove liability for or invalidity of the claim or its amount. Evidence of conduct or statements made in compromise negotiations is likewise not admissible. This rule does not require the exclusion of any evidence otherwise discoverable merely because it is presented in the course of compromise negotiations. This rule also does not require exclusion when the evidence is offered for another purpose, such as proving bias or prejudice of a witness, negativing a contention of undue delay, or proving an effort to obstruct a criminal investigation or prosecution.

> Mediation is already the treatment of choice for many U.S. corporations, particularly when the parties have a history of business dealings and intend to preserve working relationships in the future. As compared to arbitration, and especially to litigation, mediation is inexpensive and quick, often taking one day, as opposed to a median duration of sixty days for arbitration. If, for some reason, mediation fails, the options of arbitration or litigation still exist. Most often, however, mediation works. More than eighty-five percent of mediated commercial disputes are settled on mutually favorable terms. Even inconclusive mediation is often beneficial since issues are narrowed and "communications enhanced" as the process moves to either arbitration or litigation.

Mediation can also allow a settlement between the parties that is not of a legally available remedy. In *Lela P. Love,* Training Mediators for the 21st Century: Training Mediators to Listen: Deconstructing Dialogue and Constructing: Understanding, Agendas, and Agreements, 38 Fam. & Concil. Cts. Rev. 27, 31 (2000), it is noted:

> One of the unique strengths of mediation compared to litigation or arbitration is its ability to address the infinitely wide range of concerns that disputing parties have with each other. Litigation is limited to issues that are legal causes of action. Arbitration is limited to issues that are prescribed in the arbitration agreement. Mediation can address whatever the parties bring to the table, as long as the mediator is tuned in to capture the issues and incorporate each issue into the agenda. Consider, for example, the mediation of an estate matter in which siblings are disputing over the disposition of an art collection. One of the siblings raises a concern that her brother has allowed her 18-year-old son to sleep with his girlfriend in the brother's home. This is not an actionable issue in court. However, in mediation, if the mediator places on the table the son's sleeping accommodations in the brother's home and if the parties are willing to negotiate about this issue, the mediator will have provided a necessary, and very useful, building block toward constructing a better understanding of what is driving each party crazy and laying out what needs to be negotiated in order to resolve the entire conflict.

The range of verdicts and judgments are important to know in deciding to mediate or arbitrate. If the range is unpredictable, a party may be more inclined to participate in alternative dispute resolution where there is more control in the result.

The sophistication of the fact-finder (jury, judge or arbitrator) is important in deciding on the method for a dispute resolution. If the jury or judge will be less than knowledgeable about the subject matter of the dispute, the parties may select a more knowledgeable arbitrator. A

knowledgeable mediator or arbitrator will expedite the process and may result in a more reasonable result.

One party may have an emotionally charged case, which a fact-finder may find very appealing, but the party does not have legal support for the position. To avoid a jury getting this case, the opponent may consider the potential of mediation or arbitration.

Damages (Including Consequential Damages) and Related Provisions:

When a breach occurs, there are various remedies that may be pursued by the non-breaching party, which include expectation damages, reliance damages or restitution damages. *See generally Crown Coal & Coke Co. v. Powhatan Mid-Vol Coal Sales, L.L.C.*, 929 F. Supp. 2d 460, 471 (W.D. Pa. 2013) ("In general, contract law espouses three distinct, yet equally important, theories of damages to remedy a breach of contract: 'expectation' damages, 'reliance' damages, and 'restitution' damages."); *see also* Restatement § 344. Expectation damages are the preferred form of damages because it places the parties in the same position they would have been if performance had occurred, which includes the recovery of losses incurred or gains prevents. *Crown Coal & Coke Co. v. Powhatan Mid-Vol Coal Sales, L.L.C.*, 929 F. Supp. 2d 460, 471 (W.D. Pa. 2013) ("Expectation damages are the preferred approach because they place the injured party in the position that would have resulted from receiving the benefit of the bargain. The standard measurement for such damages are recovery of the losses caused and gains prevented by defendant's breach, to the extent that are in excess of any savings made possible by nonperformance.").[4]

[4] A rule of law, known as the economic loss doctrine, limits contracting parties to the recovery permitted by the contract, as opposed to a recovery on a tort basis, *i.e.* a non-contractual claim. The economic loss doctrine "refer[s] to a common law rule limiting a contracting party to contractual remedies for the recovery of economic losses unaccompanied by physical injury to persons or other property. *Flagstaff Affordable Hous. L.P. v. Design Alliance, Inc.*, 223 P.3d

(a) Expectation Damages

Expectation damages are measured as follows:

> [E]xpectation damages are calculated by (1) the loss to the non-breaching party [i.e. general damages] (2) plus any loss, including incidental or consequential loss, caused by the breach (3) less any cost or other loss that the non-breaching party avoided by not having to perform. In other words, expectation damages is measured by the amount of money that would put the promissee in the same position as if the promisor had performed the contract.

VICI Racing, LLC v. T-Mobile USA, Inc., 2014 U.S. App. LEXIS 15506 (3d Cir. 2014), citing to Restatement § 347; *see also CR-RSC Tower I, LLC v. RSC Tower I, LLC,* 56 A.3d 170, 182 (Md. 2012) ("[A] party injured by a breach of contract has a right to damages based on his expectation interest as measured by (a) the loss in the value to him of the other party's performance caused

---

664, 670 (Ariz. 2010), *see also Fennell v. Green*, 77 P.3d 339, 343 (Utah Ct. App. 2003) ("The economic loss rule prevents a party from claiming economic damages 'in negligence absent physical property damage or bodily injury.'"). The economic loss doctrine has been applied in construction defect cases to bar recovery by the owner against the contractor. In *Flagstaff Affordable Hous. L.P. v. Design Alliance, Inc.*, 223 P.3d 664, 670 (Ariz. 2010) the court held:

> Given these considerations, we conclude that in construction defect cases, the policies of the law generally will be best served by leaving the parties to their commercial remedies when a contracting party has incurred only economic loss, in the form of repair costs, diminished value, or lost profits…. We accordingly apply the economic loss doctrine and hold that a contracting party is limited to its contractual remedies for purely economic loss from construction defects.
>
> In the construction context, the economic loss doctrine respects the expectations of the parties when, as will often be true, they have expressly addressed liability and remedies in their contract. Thus, the parties can contractually agree to preserve tort remedies for solely economic loss, just as they may otherwise specify remedies that modify common law recovery…. But if the parties do not provide otherwise in their contract, they will be limited to contractual remedies for any loss of the bargain resulting from construction defects that do not cause personal injury or damage to other property.

Indianapolis-Marion County Pub. Library v. Charlier Clark & Linard, P.C., 929 N.E.2d 722, 735-36 (Ind. 2010) ("[I]n general, there is no liability in tort for pure economic loss caused unintentionally"); *but see West v. Inter-Financial, Inc.*, 139 P.3d 1059, 1063-64 (Utah Ct. App. 2006) ("When an independent duty exists, the economic loss rule does not bar a tort claim.").

by its failure or deficiency, plus (b) any other loss, including incidental or consequential loss, caused by the breach, less (c) any cost or other loss that he has avoided by not having to perform."); *Trans-Western Petro., Inc. v. United States Gypsum Co.*, 559 Fed. Appx. 773, 775, (10th Cir. Utah 2014) ("The injured party in a breach of contract action has a right to damages based upon his expectation interest as measured by (a) the loss in the value to him of the other party's performance caused by its failure or deficiency, plus (b) any other loss, including incidental or consequential loss, caused by the breach, less (c) any cost or other loss that he has avoided by not having to perform."). *CR-RSC Tower I, LLC v. RSC Tower I, LLC*, 56 A.3d 170, 182 (Md. 2012) ("Damages flowing directly from the breach are referred to as general damages. Damages are calculated differently depending on which category the claim is in—whether it is for the "value of the other party's performance" or a "consequential loss" following from the breach. [W]hen the claim is based on value, it is a 'general damages' claim, calculated as 'the difference between the contract price and the fair market value at the time of breach.'").

In addition to the direct loss resulting from the breach, *i.e.* general damages, the non-breaching party can also sustain a loss characterized as incidental or consequential, which are part of recoverable expectation damages. *See e.g.* Illustration 3, Restatement § 347. Consequential losses include, for example, the lost profits. *CR-RSC Tower I, LLC v. RSC Tower I, LLC*, 56 A.3d 170, 182 (Md. 2012) ('[W]hen lost profits are claimed for lost income from business operations that would have been made but for the breach, the claim is for "consequential" or "special" damages."). All parties involved in the construction industry face the real potential of a loss of consequential damages in the event a construction project is not completed in a timely fashion according to the plans and specifications. Consequential damages, in some instances, can actually exceed the amount of the contract of the party causing the delay

in completion. For example, when a general contractor fails to complete the construction of a commercial building, such as a hotel, as a result of its own fault, and the hotel is not opened in a timely fashion, the contractor causing the delay could be liable for all of the owners damages resulting from the delay, including such things as loss of profits during the delay period and increased finance charges. These types of damages sustained by the owner are consequential damages.

Likewise, a contractor can sustain consequential damages as a result of the default by the owner or some other party, such as a subcontractor. For example, if the owner fails to provide buildable plans and specifications for the project, which causes delays in completion of the construction, the contractor could sustain consequential damages such as extended overhead and general conditions, lost projects, increased costs due to labor, and materials increases. This same potential loss exists between the contractor and the subcontractor.

Consequential damages are only available if they are objectively foreseeable. *Sunnyland Farms v. Cent. N.M. Elec. Coop., Inc*., 301 P.3d 387, 393 (N.M. 2013) (relying on Restatement § 351, "In a contract action, a defendant is liable only for those consequential damages that were objectively foreseeable as a probable result of his or her breach when the contract was made. To the extent our earlier cases suggest a different standard, they are overruled."); *Zulfe Enters. v. Ribich*, 2013 Minn. Dist. LEXIS 123 (2013) ("A plaintiff is also entitled to reasonably foreseeable consequential damages flowing from the breach, assuming the party can show these damages were reasonably certain."); *Ash v. North American Title Co*., 168 Cal. Rptr. 3d 499 (Cal. App. 2014) ("Contract damages are generally limited to those within the contemplation of the parties when the contract was entered into or at least reasonably foreseeable by them at that time; consequential damages beyond the expectations of the parties are not recoverable."). In

Brandon & Tibbs v. George Kevorkian Accountancy Corp., 277 Cal. Rptr. 40, 48 (Cal. Ct. App. 1990), the court observed:

> [I]f special circumstances caused some unusual injury, special damages are not recoverable therefore unless the circumstances are known or should have been known to the breaching party at the time he entered into the contract. The requirement of knowledge or notice as a prerequisite to the recovery of special damages is based on the theory that a party does not and cannot assume limitless responsibility for all consequences of a breach, and that at the time of contracting he must be advised of the facts concerning harm which might result therefore, in order that he may determine whether or not to accept the risk of contracting.

The standard of foreseeability is higher than proximate or substantial cause used in tort cases. "Foreseeability is a more severe limitation of liability than is the requirement of substantial or 'proximate' cause in . . . tort." *Sunnyland Farms v. Cent. N.M. Elec. Coop., Inc.*, 301 P.3d 387, 393 (N.M. 2013) (relying on Restatement § 351 cmt. A).[5]

Accordingly, for recovery of consequential damages the damages must be caused as a result of a breach of the contract between the parties, and must have been reasonably foreseeable at the time of contracting. Additionally, the damages must be proved with reasonable certainty

[5] There are two somewhat distinct views on what is foreseeable. The more restrictive "tacit agreement" test requires the parties to have contemplated specifically that consequential damages might result, and that the defendant has actually assumed the risk of those damages. *See Am. Capital Corp. v. United States*, 59 Fed. Cl. 563, 574 (Fed. Cl. 2004); Cmts. Restat. (2d) Contracts, § 351. The more widely accepted view, however, places upon the defendant the risk of such consequential damages that "reasonable men in the position of the parties would have foreseen as a probable result of breach," without any requirement of actual consideration or assumption of such damages by the parties themselves. *Id.* In any event, the question of whether the buyer's consequential damages were foreseeable by the seller is one of fact to be determined by the trier of fact. *See Simeone v. First Bank Nat'l Ass'n*, 73 F.3d 184, 188 (8th Cir. 1996); *see also Milgard Tempering, Inc. v. Selas Corp.*, 902 F.2d 703, 710-11 (9th Cir. 1990) (awarding consequential damages in the form of lost profits where the buyer was unable to produce up to capacity as a result of the faulty performance of the purchased equipment); *Dura-Wood Treating Co. v. Century Forest Indus., Inc.*, 675 F.2d 745, 755 (5th Cir. 1982) (recognizing as a general proposition that consequential damages include the lost profits from a buyer's dealings with a third party), cert. denied, 459 U.S. 865, 103 S. Ct. 144, 74 L. Ed. 2d 122 (1982).

to be recoverable. In the Restatement 2d Contracts, § 351, "Unforeseeability and Related Limitations on Damages," regarding foreseeability, it is stated:

> (1) Damages are not recoverable for loss that the party in breach did not have reason to foresee as a probable result of the breach when the contract was made.
>
> (2) Loss may be foreseeable as a probable result of a breach because it follows from the breach
>
> (a) in the ordinary course of events, or
>
> (b) as a result of special circumstances, beyond the ordinary course of events, that the party in breach had reason to know.
>
> (3) A court may limit damages for foreseeable loss by excluding recovery for loss of profits, by allowing recovery only for loss incurred in reliance, or otherwise if it concludes that in the circumstances justice so requires in order to avoid disproportionate compensation.[6]

Accordingly, for recovery of consequential damages the damages must be caused as a result of a breach of the contract between the parties, and must have been reasonably foreseeable at the time of contracting. Additionally, the damages must be proved with reasonable certainty to be recoverable. Because the requirements for recovery of consequential damages have no objective limitations on potential recoverable damages, the breaching party is at significant risk to pay damages that could literally exceed the amount of the contract.

Because of the uncertainties associated with consequential damages arising as a result of delays in completion of construction, construction contracts frequently contain a waiver of consequential damages caused by a delay or any other cause, and, in lieu of consequential

---

[6] A limitation on consequential or incidental damages is the requirement of foreseeability, as established in the oft-cited English case of *Hadley v. Baxendale*, 156 Eng. Rep. 145 (Ex. 1854). In that case, a mill was idled because of a broken crankshaft of the steam engine that drove the mill. The shaft was entrusted to a carrier to take to its manufacturer so that a duplicate could be made to replace the broken shaft. Because the carriage was delayed, the reopening of the mill was delayed for several days. The miller sued the carrier for loss of profits as a result of the delay. The significant rule of the case is that "consequential damages" should be denied by the court unless the loss "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 the breach of it." *Id.* at 151.

damages, the contracts contain a "liquidated damages" provision, which is discussed hereafter. The waiver of consequential damages protects the breaching party for extraordinary damages, and protects the non-breaching party by providing a remedy and eliminating the uncertainties of proving damages.

A typical waiver of consequential damages is as follows:

> The Contractor and Owner waive Claims against each other for consequential damages arising out of or relating to this Contract. The mutual waiver includes:
>
> .1 damages incurred by the Owner for rental expenses, for loss of use, income, profit, financing, business and reputation, and for loss of management or employee productivity or of the service of such persons; and
>
> .2 damages incurred by the Contractor for principal office expense including the compensation of personnel stationed there, for losses of financing, business, reputation, and for the loss of profit except anticipated profit arising directly from the Work.

(b) Reliance Damages

Reliance damages are recoverable when expectation damages are not. *See Crown Coal & Coke Co. v. Powhatan Mid-Vol Coal Sales, L.L.C.*, 929 F. Supp. 2d 460, 471-72 (W.D. Pa. 2013) ("Reliance damages may be pursued where the ability to recover expectation damages is clouded because of the uncertainty in measuring the loss in value to the aggrieved contracting party."). Reliance damages are intended to protect the injured party's reliance interest by placing the party in the position it would have been had the contract not been made. *See Id.; MC Baldwin Fin. Co. v. DiMaggio, Rosario & Veraja, LLC*, 845 N.E.2d 22 (Ill App. 2006) (citing Restatement § 344, "Illinois law thus allows an injured party to recover, as an alternative measure of damages, its expenditures in partly performing its own obligations under a contract as an alternative measure of damages where the usual method would be too speculative."). Remedies for injury to a reliance interest are defined as "being reimbursed for loss caused by reliance on the contract by

being put in as good a position as the injured party would have been in had the contract not been made." Restatement § 344(b).

Reliance damages consist of the costs incurred in connection with the preparation for performance or actual performance of the contract. *See e.g. Amigo Broad., LP v. Spanish Broad. Sys.*, 521 F.3d 472, 485 (5th Cir. 2008):

> Amigo also asserts that it produced sufficient evidence of its loss of $250,000, which constitutes the lost investment that Amigo spent to advertise and promote the El Chulo Show. With respect to such investment, Amigo is seeking reliance damages which reimburse one for expenditures made towards the execution of the contract in order to restore the status quo before the contract. Although not stated by Amigo's briefs, Amigo's evidence of lost investment presents an alternative theory of recovery-that is, Amigo can ultimately recover for its lost profits or its lost investment but not both.

Id.; see also Tipton v. Mill Creek Gravel, Inc., 373 F.3d 913, 921 (8th Cir. Mo. 2004)("We also hold that Mill Creek may be entitled to recover the loss it incurred to get its gravel operation up and running in reliance on the preincorporation agreement."). Reliance may also consist of preparation for collateral transactions that the non-breaching party had planned based upon the performance of the contract.[7]

(c) Restitution Damages

Restitution damages may be elected at the exclusion of the other compensatory remedies. See *Crown Coal & Coke Co. v. Powhatan Mid-Vol Coal Sales, L.L.C.*, 929 F. Supp. 2d 460, 472 (W.D. Pa. 2013). "Restitution damages are a measure of damages available for breach-of-

[7] Examples of "reliance" damages are included as illustrations in the Restatement § 349:

> A contracts to build for B a factory of experimental design for $ 1,000,000. After A has spent $ 250,000 and been paid $ 150,000 in progress payments, B repudiates the contract and A stops work. A's expenditures include materials worth $ 10,000 that he can use on other jobs. If neither party proves with reasonable certainty what profit or loss A would have made if the contract had been performed, A can recover as damages the $ 90,000 balance of his expenditures in preparation for performance.

contract claims; their purpose is to restore what the plaintiff has conferred on the defendant rather than to compensate the plaintiff." *Marrs & Smith P'ship v. Sombrero Oil & Gas Co., L.L.C.*, 2014 Tex. App. LEXIS 5332(Tex. App. 2014). In *Little Mts. Enters. v. Groom*, 64 A.3d 781, 786 (Conn. App. Ct. 2013), the court explained restitution damages as follows:

> The remedy of rescission and restitution is an alternative to damages in an action for breach of contract. Rescission, simply stated, is the unmaking of a contract. It is a renouncement of the contract and any property obtained pursuant to the contract, and places the parties, as nearly as possible, in the same situation as existed just prior to the execution of the contract. Restitution is an equitable remedy under which a person is restored to his or her original position prior to loss or injury, or placed in the position he or she would have been, had the breach not occurred.

In the case of *Norfolk Southern Ry. Co. v. Basell USA, Inc.*, 2008 U.S. Dist. LEXIS 62390, 34-35 (E.D. Pa.), the court observed regarding the recovery of restitution type damages:

> Historically, damages for breach of contract have been limited to the non-breaching parties' expectation interest…. However, where a breach is material, the injured party may seek restitution as an alternative remedy…. The purpose of restitution is to require the wrongdoer to restore what he has received and thus put the injured party in as good a position as that occupied by him before the contract was made… A party's restitution interest is measured by either (a) the reasonable value to the breaching party of what he received in terms of what it would have cost him to obtain it from a person in the claimant's position, or (b) the extent to which the breaching party's property has been increased in value or his other interests advanced. Recovery under a restitution theory is not limited by the value of the contract.

The basic rules of restitution damages are stated in Restatement § 373 as follows:

> (1) Subject to the rule stated in Subsection (2), on a breach by non-performance that gives rise to a claim for damages for total breach or on a repudiation, the injured party is entitled to restitution for any benefit that he has conferred on the other party by way of part performance or reliance.
>
> (2) The injured party has no right to restitution if he has performed all of his duties under the contract and no performance by the other party remains due other than payment of a definite sum of money for that performance.[8]

[8] There are other recognized damage rules that apply in unique or non-typical circumstances. These specialized rules are described in Restatement §348 as follows:

(d) Mitigation and Avoidance

When a party is injured by a breach of contract, the injured party has a duty to mitigate the injury and avoid additional loss, to the extent it is reasonable to do so. *VICI Racing, LLC v. T-Mobile USA, Inc.*, 2014 U.S. App. LEXIS 15506 (3d Cir. 2014) ("[A] party has a general duty to mitigate damages if it is feasible to do so…. But whether mitigation is required depends upon the circumstances of the case and is subject to a rule of reasonableness."); *Scheck Indus. Corp. v. Tarlton Corp.*, 435 S.W.3d 705, 729 (Mo. Ct. App. 2014) ("Under the rule of mitigation of damages, one damaged through alleged breach by another of some legal duty or obligation has to make reasonable efforts to minimize the resulting damage…. Thus, losses that could reasonably have been avoided are not recoverable."); *Degla Group for Invs., Inc. v. Boconcept USA, Inc.*, 2014 U.S. Dist. LEXIS 110028 (C.D. Cal. 2014) ("The duty to mitigate damages is not an unlimited one and an injured party is required only to exert reasonable efforts to prevent or minimize his damages within the bounds of common sense.).[9]

---

(1) If a breach delays the use of property and the loss in value to the injured party is not proved with reasonable certainty, he may recover damages based on the rental value of the property or on interest on the value of the property.

(2) If a breach results in defective or unfinished construction and the loss in value to the injured party is not proved with sufficient certainty, he may recover damages based on:

(a) the diminution in the market price of the property caused by the breach, or

(b) the reasonable cost of completing performance or of remedying the defects if that cost is not clearly disproportionate to the probable loss in value to him.

(3) If a breach is of a promise conditioned on a fortuitous event and it is uncertain whether the event would have occurred had there been no breach, the injured party may recover damages based on the value of the conditional right at the time of breach.

[9] Restatement § 350 states:

What the injured party is required to do in order to mitigate or avoid damages is not always clear. The rule of mitigation of damages may not be invoked by a breaching party as "a basis for hypercritical examination of the conduct of the injured party." *Sunpride (Cape) (Pty) Ltd. v. Mediterranean Shipping Co.*, 2003 U.S. Dist. LEXIS 20333, at *37 (S.D.N.Y. 2003). The breaching party is precluded from complaining about a lack of mitigation if the breaching party could have taken the same action. In *Toyota Industrial Trucks U.S.A., Inc. v. Citizens Nat'l Bank*, 611 F.2d 465 (3d Cir. Pa. 1979) the court stated:

> [W]here both the plaintiff and the defendant have had equal opportunity to reduce the damages by the same act and it is equally reasonable to expect a defendant to minimize damages, the defendant is in no position to contend that the plaintiff failed to mitigate. Nor will the award be reduced on account of damages the defendant could have avoided as easily as the plaintiff. . . . The duty to mitigate damages is not applicable where the party whose duty it is primarily to perform a contract has equal opportunity for performance and equal knowledge of the consequences of the performance.

Id. at 471.

Not uncommonly, a breaching party will make an offer to the injured party to provide a substitute performance if the injured party waives all claims as a result of the breach. Under such circumstances, the injured party is not required to accept the substitute performance. In *Teradyne, Inc. v. Teledyne Industries, Inc.*, 676 F.2d 865 (1st Cir. 1982) the court stated:

> As Restatement (Second) Contracts, § 350 Comment c indicates, there is no right to so-called mitigation of damages where the offer of a substitute contract "is conditioned on surrender by the injured party of his claim for breach." "One is not required to mitigate his losses by accepting an arrangement with the repudiator if that is made conditional on his surrender of his rights under the repudiated contract."

> (1) Except as stated in Subsection (2), damages are not recoverable for loss that the injured party could have avoided without undue risk, burden or humiliation.
>
> (2) The injured party is not precluded from recovery by the rule stated in Subsection (1) to the extent that he has made reasonable but unsuccessful efforts to avoid loss.

Id. at 870; *see also Fischer v. Heymann*, 12 N.E.3d 867, 872 (Ind. 2014) ("Under these circumstances, … Fischer did not need to surrender to the very demand which generated the breach to mitigate her damages. Just as breaching parties may not take advantage of their breach to relieve them of their contractual duties, … neither may they take advantage of their breach to require non-breaching parties to perform beyond their contractual duties."); *DeVries Dairy, LLC v. White Eagle Coop. Ass'n*, 2014 U.S. Dist. LEXIS 81346 (N.D. Ohio 2014) ("[T]he obligation to mitigate does not require the party to incur extraordinary expense and risk…. Ordinary and reasonable care, diligence and prudence are the measure of the duty.").[10]

---

[10] *See e.g. Toucan Partners, LLC v. Hernando County*, 2014 U.S. App. LEXIS 12979 (11th Cir. 2014):

> In this case, the County's sole theory of mitigation was that Narconon could have procured additional buildings at offsite locations to house its clients. Contrary to the County's arguments, it was not reasonable to expect Narconon to fundamentally alter its treatment and program model from an onsite, residential service to an offsite program with facilities scattered throughout the community. Strickling testified that the onsite facilities provided clients with one-on-one monitoring from staff members 24 hours per day, seven days per week, that the success rate of outpatient programs is not as high as residential programs, and that Narconon's residential program was designed to provide therapeutic benefits by mimicking family life in that clients would work, eat, and enjoy recreational activities together. Forcing Narconon to procure offsite housing, change its treatment model, and set up the attendant transportation and staffing infrastructure to run multiple offsite locations was not a reasonable option.

RHJ Med. Ctr., Inc. v. City of DuBois, 564 Fed. Appx. 660, 667 (3d Cir. 2014)

> RHJ's primary argument on appeal is that the District Court ignored its reasonable mitigation efforts and instead focused exclusively on one additional action the City contends RHJ could have pursued: seeking to rent space from DRMC. We do not read the District Court's opinion in such a manner. Instead, we interpret the District Court's opinion as concluding that in a small town like DuBois—which has only about 8,000 residents and covers just three-and-a-half square miles—it was unreasonable for RHJ to fail to contact the regional medical center to inquire whether it had space available for lease that was suitable for RHJ's purposes. The District Court, after reviewing the evidence presented at trial, concluded that DRMC had space available and would have leased to RHJ if called upon. The District Court thus found that RHJ's failure to contact

(e) Liquidated Damages

Liquidated damages provisions are inserted into construction contracts to compensate the owner for delays caused by the contractor, but limit the amount the amount of recoverable damages to the "liquidated" amount, as opposed to allowing recovery of all consequential damages. Although liquidated damages are generally perceived as hostile to the contractor, and favoring the owner, in fact the provisions can reduce the exposure to the contractor, as discussed hereafter.

A typical liquidate damage clause in the contract between the owner and the contractor is as follows:

> If the Work is not brought to final completion in accordance with the Drawing and Specifications, including authorized Changes, by the date specified above, or by such date to which the Contract may be extended, whichever is later, the Contract Amount shall be reduced in an amount of $_____, as liquidated damages, for each day of delay until the date of final completion.

A subcontract may include a provision protecting the general contractor as follows:

> If Subcontractor should default in performance of the Work or otherwise commit any act which causes delay to the prime contract work, Subcontractor shall be liable for all losses, costs, expenses, liabilities and damages, including consequential and liquidated damages, sustained by Contractor, or for which the Contractor may be liable to Owner or any other party because of Subcontractor's default.

The objective for liquidated damages is to secure the timely performance that is promised by the contractor. Liquidated damages may be estimated as a daily rate for the period of late performance using components such as: operational and maintenance costs, rental, interest, loss revenue, among other things. If the amount specified for liquidated damages is a reasonable

---

> DRMC—due to an unfounded belief that DRMC would not be cooperative—effectively rendered RHJ's mitigation efforts, as a whole, unreasonable.

quantifying measure of convenience or is not disproportionate to the value of the performance promised and consideration paid, the liquidated damages provision will be enforced.

States have differing tests to determine the enforceability of liquidated damage clause. A general rule for enforceability is as follows:

> (1) An agreement, made in advance of breach fixing the damages therefore, is not enforceable as a contract and does not affect the damages recoverable for the breach, unless
>
> (a) the amount so fixed is a reasonable forecast of just compensation for the harm that is caused by the breach, and
>
> (b) the harm that is caused by the breach is one that is incapable or very difficult of accurate estimation.

As noted, the inclusion of a liquidated damages clause in a contract is generally deemed to be in lieu of actual consequential damages for delay. A party is not generally entitled to collect both liquidated damages and actual damages, except where liquidated damages are limited to certain specified types of damages, or where other damages which may occur are specifically excluded in the liquidated damages calculation, such as claims of other contractors affected by the delay. Likewise, a party cannot circumvent the liquidated damages clause because its actual damages are greater, unless the liquidated damages are qualified by such exclusions.

The material appearing in this website is for informational purposes only and is not legal advice. Transmission of this information is not intended to create, and receipt does not constitute, an attorney-client relationship. The information provided herein is intended only as general information which may or may not reflect the most current developments. Although these materials may be prepared by professionals, they should not be used as a substitute for professional services. If legal or other professional advice is required, the services of a professional should be sought.

The opinions or viewpoints expressed herein do not necessarily reflect those of Lorman Education Services. All materials and content were prepared by persons and/or entities other than Lorman Education Services, and said other persons and/or entities are solely responsible for their content.

Any links to other websites are not intended to be referrals or endorsements of these sites. The links provided are maintained by the respective organizations, and they are solely responsible for the content of their own sites.