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A Deep Dive into Damages: Show Me the Money!

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A Deep Dive into Damages: Show Me the Money!

Years ago, a mentor of mine regaled me with a story of his early days as an newly minted in-house lawyer at a general contractor. He had just had what he viewed as a great day in court – he defeated the other side's motion to dismiss and his client's case survived to be pursued through the litigation process. He returned to the office exited to tell his boss, the CFO, about his victorious court appearance. The CFO's response, "Where's the check? We don't pay you to have fun in court. Come back when you have a check for me." Perhaps a harsh, but important lesson – business litigation is most often about one thing: money.

After nearly 30 years as a litigator specializing in representing General Contractors and Construction Managers in complex business disputes, I have come to recognize that many clients, and some attorneys, focus their efforts, both during the project and during dispute resolution efforts, almost exclusively on proving the other party's liability (or defending against their own) and too often give too little attention to documenting their costs (aka "damages") in real time and in developing strategic approaches to proving (or defending against) damages at hearings (trials or arbitrations).

Litigators view disputes as having two broad components – liability and damages. The liability component is almost always the "sexier," more interesting part of the case. That's where you get to show how well your client performed their obligations, or how the other party's bad acts prevented your client from fully performing, and where all the interesting job-stories come out through witness testimony. But without proving entitlement to and quantum of damages, victories can be pyrrhic. A finding that the other party breached and is liable, does not, alone, equate to securing your client's recovery.

Shouldering the Burden:

Generally, a party seeking a recovery in a legal proceeding for the other party's breach of contract is entitled to seek, to prove and to recover their "expectancy damages," those funds needed to make itself whole and to put it in the position it would have been "but for" the other party's breach. However, commercial contracts often contain provisions that limit the damages that may be recovered: consequential damages waivers; liquidated damages for delay in lieu of actual damages, often subject to a cap; "no damage for delay" clauses; among other "exculpatory" clauses whereby the parties define the kinds of damages that their business deal dictates are and are not potenetially recoverable.

Each party seeking a breach of contract recovery bears the burden of proving its entitlement "by a preponderance of the evidence." This is often taught as only needing to prove that your version of events is more likely true than the other side's, equating to having to prove that there is slightly more than a 50% chance that you are right. But is a "preponderance" enough in practice? Technically yes, practically probably not.

The law in most US jurisdictions typically provides that once the fact that a damage occurred is proven, the calculation of the resulting damages need not be precise. A reasonable basis for the damages computations is technically good enough. But if the proof is vague or speculative, it

won't suffice. Moreover, a lack of precision significantly impairs credibility. If your proofs are not precise, you better have a compelling reason as to why precision is not possible, or the judge, jury or arbitrator may be skeptical. Moreover, occasionally the contract documents may set the proof-bar, by expressly raising the burden to "beyond a reasonable doubt" (akin to that burden imposed on prosecutors to prove a criminal defendant's guilt) or by "clear and convincing evidence" (the intermediate burden by which civil fraud is typically required to be proven). Some contracts dictate the kinds of proof that must be relied upon, rejecting industry studies for loss of productivity damages, for example, requiring the claiming party to rely exclusively on project-specific proofs (like a measured mile approach).

Regardless of the technical legal burden that applies, the more detailed and precise the damages computations and back up are, the more you promote the credibility of your entire case. Human nature wants compelling and credible proof. Judges, juries and arbitrators may not be comfortable with close calls. To promote your chances of victory, you better have the goods collected in real time during the project and be ready to present them, often years after the fact, in a credible and compelling way.

Key damages concepts to guide strategic damages proof considerations include proving: the *fact* that the damages sought were incurred as a result of the other party's breach; the *quantum* of each category of damages; that the damages incurred were *reasonable*; and, if challenged, that the claiming party reasonably endeavored to *mitigate* the extent of the damages. The last consideration, the duty to mitigate, is implied by law, but it does not require Herculean efforts, nor are those efforts to be judged with 20/20 hindsight. Rather, the efforts (even if unsuccessful) need only have been reasonable under the circumstances at the time they were incurred. Thus, making a real time record of those efforts, and why they were or were not successful, but were nevertheless reasonable, is critical to be able to meet this requirement.

A Subcontractor Default Insurance Digression:

The SDI carriers, in their claims processes, typically impose a higher burden on their insureds pursuing claims as a result of a subcontractor's default than would be imposed by a court or arbitration panel either in a dispute between the prime contractor and the defaulted subcontractor or in dispute between the insured and its carrier over the claim. The carriers typically only look at "contemporaneous project documentation," declining to consider witness testimony (or after-the-fact sworn affidavits), to explain or supplement the documentary record. A court or arbitrators do not usually look at records alone, often requiring them to be supplemented and explained (and admitted into evidence) by witness testimony. Similarly, SDI carriers often seek proof of payment of costs in the form of cancelled checks or confirmed wire transfers, whereas a court or arbitrator would typically be convinced by business accounting records documenting expenditures, once authenticated and validated by a competent witness familiar with the costs incurred and the company's business record keeping practices.

The more rigorous SDI carrier vetting process can potentially be of benefit to the insured when it comes time to pursue the defaulted subcontractor. For example, in *Davis Specialty Contracting, Inc. v. Turner Construction Company,* 2016 WL 675909 (ED Mich 2016), the court's ruling after a bench trial noted with approval the fact that Turner's SDI insurer, Zurich and its outside

"independent consulting company" had extensively analyzed and vetted Turner's damages proofs: "[the]Court highlights [Zurich's consultant's] work to underscore that Turner's default-damages went through several layers of review," and "Even without the additional review [by the consultant and Zurich] the court would accept [Turner's expert's] analysis, but that additional review gives the court added comfort."

What types of damages does a GC/CM typically incur?

The categories of damages incurred can vary widely depending on the nature of the other party's breach and the increased costs incurred by the GC or CM. Contract sums unpaid by an owner for base contract work or extra work (undisputed and disputed) are typical damages categories sought against an owner.

In the event of a defaulted subcontractor claim, costs of completion, correction, material escalation, and additional staff costs required to manage completion or correction work are typical cost categories incurred by GCs and CMs.

Delay damages may be sought from an owner or from a subcontractor (or both) depending on who caused or contributed to project delay. Extended staff costs, general conditions, general requirements, insurance costs, material and wage rate escalation costs, home office overhead, acceleration costs to mitigate delay and other time-related costs are often pursued.

Direct versus Consequential – no end of confusion:

Many non-lawyer industry professionals have a general understanding that there is a critical distinction between "direct" (aka "general," "compensatory" or "benefit of the bargain" damages) and "consequential" (aka "special") damages. The line between what is direct and what is consequential in a given case is often not clear. Lawyers and courts are all over the map in trying to draw a clear line between the two that applies in all circumstances. As one court put it: the term "consequential damages" is subject to many interpretations and "no two courts or treatises define consequential damages the same way." *Team Contractors, L.L.C. v. Waypoint NOLA, L.L.C.,* No. CV 16-1131, 2017 WL 4366855, at *4 (E.D. La. Sept. 29, 2017).

The cases provide, at best, vague guidance to distinguish between the two categories, often characterizing "direct" damages as those that "naturally and directly flow from the breach," while "consequential" damages also flow naturally from the breach, but are typically more removed and may be a result "of the injured party's 'special circumstances.'" Clear, right?

As a rule of thumb in construction disputes, costs tied directly to the project at issue, like completion or correction costs, or delay-related costs, or the contractors lost profits on the project at issue, are likely "direct" damages. If the owner properly terminates the prime contractor, few would dispute that the excess cost of completing the project with a replacement contractor is a "direct" damage. The owner's interest carry costs, lost profits resulting from the inability or delayed ability to use the facility under construction, lost business opportunities, and the like are usually considered consequential vis-à-vis the owner. For the contractor, lost profits on other projects that it could not undertake because delay tied it up on the project at issue, is a prime

example of a consequential damage. But the cases are all over the map parsing these issues in different factual circumstances. The inability to draw a bright line between direct and consequential damages is rooted in many causes, one of which is that they are very situationally dependent. One party's direct damage may be another party's consequential damage. What is consequential to an owner may be direct to the GC when the GC is looking to recover those same damages from its defaulted subcontractor.

Absent a contractual waiver of consequential damages, both direct and consequential damages are potentially recoverable, although to prove entitlement to consequential damages, additional elements must be proven. Usually, to recover consequentials, the claimant must additionally prove that the damages were in the reasonable contemplation of the parties at the time of contracting and that they are not speculative. For example, if the project is for a new widget factory and the contractor delayed the project's completion, the owner would bear the burden of proving that the potential for the owner to loose profits for the inability to push widgets off the assembly line was sin the parties' contemplation at the time of contracting. It would also have to prove what its profits would have been for the widgets it was unable to manufacture and sell. That latter element can be a challenge for a new factory making a new product (or any new venture without a proven profit track record), without a profit history to rely upon and the case books are filled with decisions finding such theoretical losses too speculative.

An owner's consequential damages could expose a contractor to untold and unlimited risk. For example, if a new NFL stadium project is not timely completed, the owner's lost revenues for missing a season could be astronomical. Few, if any qualified contractors would agree to build such a facility for industry-standard profit margins if they were exposed to such potentially existential risk. Thus, "mutual" waivers of consequential damage clauses are often included in prime contracts. A typical waiver clause may read as follows:

> 6.6 LIMITED MUTUAL WAIVER OF CONSEQUENTIAL DAMAGES Except for damages mutually agreed upon by the Parties as liquidated damages in section 6.5 and excluding losses covered by insurance required by the Contract Documents, the Owner and the Constructor agree to waive all claims against each other for any consequential damages that may arise out of or relate to this Agreement, except for those specific items of damages excluded from this waiver as mutually agreed upon by the Parties and identified below. The Owner agrees to waive damages, including but not limited to the Owner's loss of use of the Project, any rental expense incurred, loss of income, profit or financing related to the Project, as well as the loss of business, loss of financing, loss of profits not related to this Project, loss of reputation or insolvency. The Constructor agrees to waive damages, including but not limited to loss of business, loss of financing, loss of profits not related to this Project, loss of bonding capacity, loss of reputation or insolvency. The provisions of this section shall also apply to the termination of this Agreement and shall survive such termination. The following are excluded from this mutual waiver: None; unless identified elsewhere in the Contract Documents.

Consensus Docs, 200, Standard Agreement and General Conditions Between Owner and Constructor, 2014.

Because the cases are so vague in defining and drawing distinctions between direct and consequential damages, those skilled at drafting construction contracts endeavor to clearly define in the agreement what the parties agree are consequential and, thus, waived. Unique projects, with special risks warrant special attention in the drafting of the waiver to ensure that all of the anticipated, but intended to be waived, damages are clearly within the ambit of the waiver. Otherwise, it is left to the litigators and the courts to wade through the uncertainty when a dispute arises, leaving both parties potentially exposed to liability they might not have intended to be in play, and they are certainly exposed to costly legal fees to fight about where the line should be drawn.

While a consequential damages waiver clause is usually a "must have" for the contractor in its contract with the owner, the inclusion of a waiver in subcontracts is typically to be avoided. At the very least, if a subcontractor insists on one, it should be deliberately negotiated and limited scope. GCs and CMs usually seek to keep their subcontractors liable for all of the damages incurred in the event of their breach and exposure to a subcontractor's consequential damages in the event of a GC/CM breach is usually limited. Thus, the downside of a consequential damages waiver in a subcontract usually far outweighs any benefit for the GC/CM. Another key subcontract pitfall – do not limit a subcontractor's delay-related exposure to the pass-through of the GC/CM's liquidated damages exposure to the owner. In addition to that cost exposure, if a subcontractor delays the project, the GC/CM will have its own increased costs, and potentially costs to other trades as a result of the delay, that should be maintained as recoverable in the event of a subcontractor breach.

The liquidated damages trade off:

Because consequential damages waiver clauses usually have owners waiving lost profits and other costs associated with delayed completion of the project, the business trade off for that waiver is often the contractor's agreement to pay liquidated damages in the event it is at fault for the project's delayed completion. Liquidated damages have potential benefits for both owners and contractors. For the owner, a key benefit is it no longer has to prove its actual damages. Once it proves the extent of the delay for which the contractor is solely responsible, the rest is math, multiplying the number of days of contractor-caused delay by the contractually established rate. For the contractor, it can limit its exposure for delay-related costs by negotiating the daily rate to be applied and, potentially capping its liquidated damages exposure at a fixed limit.

While the laws relating to the enforceability of liquidated damages clauses varies somewhat from jurisdiction to jurisdiction, usually they cannot be so high as to constitute a penalty and instead must be reasonably proportionate (or at least not greater than), the projected actual damages that the owner would be anticipated to incur in the event of a contractor-caused delay.

Some practical, strategic, guidance for improving real-time record keeping:

The best, most compelling and least costly evidence is often a good real-time project record. But many construction industry operations forces, while excellent and experienced builders, are not experienced proof-gatherers or creators. Most (thankfully) have never been through a legal battle. Without knowing what the trial or hearing end-game looks like, many do not have the benefit of that experience to inform how the keep project records to promote litigation success. Thus, as soon as a GC or CM knows a dispute is brewing, a damages strategy kick off, led by those who know the proof-ropes, is advisable. There is no one size fits all answer, as every case is unique, or at least a variation on a theme. Moreover, keeping diligent track of the various costs that may need to be tracked can be burdensome and further stretch already burdened project teams dealing with default or other issues that drove the need to track damages in the first place.

While after the fact forensic analysis can often serve to fill or supplement the real time record keeping effort, it is almost always more costly to bring in experts to do a forensic effort than to have the project staff keep track in real time. It is also often more persuasive to have those whose boots were on the ground ultimately testify to the damages issues than to have experts to do primarily. While expert analysis and testimony may nevertheless be required, depending on the nature of the case, when it is solidly grounded in the real time record, case outcomes surely improve.

"Separate and document" is a good guiding mantra. Different costs will inevitably face different challenges from the other parties to a dispute. Consequently, separating costs into as many discrete buckets as possible, up front, and not just using one or two cost codes for tracking, provides flexibility when trying to tie costs to liability. Teasing out discrete cost categories after the fact is often possible, but at cost and effort. Avoid some common mistakes such as: setting up codes but not allocating any costs to them; lumping discrete costs together; using the damages tracking cost codes as a "dumping ground" without proper vetting; moving costs between codes after the fact (while this may be fine, it may also require explanation to validate); and difficulty tying cost code entries to source documents such as invoices or time sheets.

For extra work claims, on the liability side of the equation, the claiming party must first provide that the work underlying the claim was in fact extra, not base scope, and is compensable. For lump sum extras, usually detailed trade contractor back up is needed to justify and validate the lump sum value. For disputed unit price work, quantities will certainly benefit from being validated with contemporaneous records and, if no unit rate was contractually fixed, the rate itself may require proof of validity. T&M work often requires justification as to why time and material was the appropriate cost tracking methodology under the circumstances, and of course valid T&M back up (and compliance with any contractual sign of requirements) should be maintained.

When the genesis of the disputed claim relates to the cost to complete or correct a defaulted or terminated subcontractor's work, it is often challenging to find a new contractor to take on the remaining scope on a lump sum basis. But if possible, try to seek multiple bids. If not possible, make a real time record of why it was not possible. For example, if multiple replacement subcontractors declined to bid lump sum, gather and keep that written record to justify use of a time and material contract basis. Buy out completion scope "apples-to-apples," do not add extra or additional work blended into the original completion contractor buy out. If you must, document it separately and use an break out number or an add-alternate for that new or different scope that

would not be properly chargeable to the defaulted subcontractor. If not taking a low bidder, or there was very limited bidder interest – document those facts as well.

Photographs, videos, drone footage, "google-earth" type project walk through records can all be highly compelling evidence of the state of completion of a project at given critical points. If a subcontractor, for example, abandons the work or otherwise is terminated, and the status of the work is likely to be the subject of dispute, make a comprehensive image record of the work status before conditions change. And make the effort to describe, either through narration or write ups (or better yet, both) of what those images show. The lawyers, judges, juries or arbitrators later on are not going to know what they are looking at or why it is significant without a narrative guide. While it may seem burdensome to do so in real time, it is far less burdensome than sifting through thousands of job photos years later and trying to make the explanations then.

GC/CM staff time is often overlooked for discrete tracking. Project Managers, for example, may simply keep a weekly time card reflecting they are full time on a given project, without any further detail. If that Project Manager, however, needs to dedicate a significant portion of her time to managing the consequences of a subcontractor default, or a major owner-related claim issue, for example, that cost could potentially be recoverable. But if it is not discretely tracked, it becomes very difficult to convincingly prove. A simple daily log tracking the time spent addressing these issues, with a short description of the activities underlying the time, and clearly tying those activities to the claim issues, solves these proof problems. But of course, this requires an up-front strategic plan to ensure these efforts are expended.

The wrap up:

Every project and every claim and dispute differ in their particulars. There is no one size fits all, off the rack check list that can be provided to help manage these often complex and unique challenges. But they can be effectively addressed by some strategic thinking and collaboration between those who know how to go about proving claims and those who know the intricacies of the project, what costs are likely to be incurred and by establishing appropriate tracking methods. While these efforts may appear to be burdensome, guaranteed it will be less burdensome, less costly and more effective to make the investment up front, rather than trying to do so forensically, after the fact.