Owner’s Damages for Construction Defects:
A Primer

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Owner’s Damages Generally

General Rule:

Owner is entitled to be placed in the same position as if the work or design had not been defective, and is generally entitled to recover for all loss actually suffered.
Subject to certain limitations, the injured party 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 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.

See Restatement (2d) Contracts § 347
Loss of Value Caused By Defective Performance

“(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.”

See Restatement (2d) Contracts § 348(2).
“Economic Waste” Doctrine

Owner “can usually recover damages based on the cost to remedy the defects. Even if this gives him a recovery somewhat in excess of the loss in value to him, it is better that he receive a small windfall than that he be under compensated by being limited to the resulting diminution in the market price of his property.

“Sometimes, however, such a large part of the cost to remedy the defects consists of the cost to undo what has been improperly done that the cost to remedy the defects will be clearly disproportionate to the probable loss in value to the injured party. Damages based on the cost to remedy the defects would then give the injured party a recovery greatly in excess of the loss in value to him and result in a substantial windfall. Such an award will not be made…. This diminution in market price is the least possible loss in value to the injured party, since he could always sell the property on the market even if it had no special value to him.”

See Restatement (2d) Contracts § 348, comment c.
“Economic Waste” Examples

“3. A contracts to build a house for B for $100,000. When it is completed, the foundations crack, leaving part of the building in a dangerous condition. To make it safe would require tearing down some of the walls and strengthening the foundation at a cost of $30,000 and would increase the market value of the house by $20,000. B's damages include the $30,000 cost to remedy the defects.

“4. A contracts to build a house for B for $100,000 according to specifications that include the use of Reading pipe. After completion, B discovers that A has used Cohoes pipe, an equally good brand. To replace the Cohoes pipe with Reading pipe would require tearing down part of the walls at a cost of over $20,000 and would not affect the market price of the house. In an action by B against A, A gives no proof of any special value that Reading pipe would have to him. B's damages do not include the $20,000 cost to remedy the defects because that cost is clearly disproportionate to the loss in value to B. B can recover only nominal damages.”

Restatement (2d) Contracts § 348, illustrations 3 and 4
The “Fix”

Doctrine of Economic Waste often makes the question of the most feasible and economically reasonable repair (the “fix”) one of the most important questions in a defect case. The concept is that a repair that differs somewhat from the original design may be sufficient to place the owner in the essentially same position regarding value of performance as a more expensive tear out and replace remedy.

Example: Office building in Austin, Texas with defective cladding. Several years after construction, cracks began to appear in GFRC cladding of building exterior. From Contractor’s perspective, issue appeared to be mostly cosmetic as opposed to structural. Contractor proposed a fix of Dryvit over cladding to solve the cosmetic problem. (Dryvit had been successfully used on high end buildings in that locale.) Owner contended that problem could only be solved by removal of the GFRC cladding and support system in its entirety and replacement with a new material.

Example: Sewage pipelines not installed to the slope specified. Concerns about flow. Very costly to remove and replace. Contractor pointed out that the system was operating properly. Proposed that rather than remove and replace, Owner take a credit for the cost of a fund for cleaning and repair as necessary.
Combination of Cost of Repair and Diminution of Value

In some cases, the measure of damages has been cost of repair sufficient to make the project work plus diminution in value. In Northern Petrochemical Co. v. Thorsen & Thorshov, Inc., 297 Minn. 118, 211 N.W.2d 159 (1973), the owner of an industrial plant recovered both loss of value and cost of repair damages against the architect and the contractor where the defective design and construction required a partial reconstruction of the structure. The court noted that the building was still worth less after the partial reconstruction than its value would have been if it had been properly constructed. The owner was entitled to recover both the actual costs of repair and the loss of value so long as the total damages did not exceed either the costs of full reconstruction or the diminution of value without any reconstruction.
The theory is that the Owner is not entitled to be compensated for corrective design features for which it did not pay in the first instance.

In St. Joseph Hospital v. Corbetta Construction Co., 21 Ill. App. 3d 925, 943, 316 N.E.2d 51, 64 (1974), the architect was liable for negligently specifying paneling which did not meet the “flame spread” requirements of the city building code. The Court held that while the hospital was entitled to recover the costs paid for the incorrectly specified defective paneling and its removal, it was not entitled to recover the extra costs and labor expense for installing the more expensive paneling required by the code. The hospital had, in fact, under the construction contract, paid only for the less expensive paneling and it would have been unjustly enriched if it received the more expensive wall paneling free of charge.

In Grossman v. Sea Air Towers, Limited, 513 So.2d 686 (Fla. App. 1987), a concrete deck open to service vehicles collapsed because under designed to support the traffic load. Although the design was sufficient for the originally contemplated use of the deck, the architect and its structural consultant negligently failed to advise the owner of the need for an increased structural capacity after the traffic pattern was redesigned to accommodate heavy service vehicles. However, the damages for which the professionals were liable were limited to the costs of restoring the deck to its original condition plus related losses occasioned by the interruption or adverse effect on business operations. They were not liable for construction costs required to increase the load capacity of the deck to accommodate heavy service vehicles since that “would have been the owners’ responsibility even if there had been no negligence on the part of the defendants.”
Betterment: Economic Upgrade

Example: Austin Office Building. Owner removed all of the GFRC cladding, replaced it with a granite cladding; also, added full length windows in the office areas. Contractor presented evidence to show that the “repairs” had the effect of converting what would have been Class B office space into Class A office space, with concomitant increase in rental rates and building value, which we contended should be an offset to costs of “repair” in the interest of avoidance of windfall.

Note: This illustrates that financial and appraisal experts must often be added to the mix along with the engineering experts.
Unforeseeable Losses

Rule in Contract Actions

“(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...”

See Restatement (2d) Contracts § 351

Distinguished From Rule in Tort (Negligence) where only limitation is Proximate Cause
Example of Unforeseeable Loss

“A, a carrier, contracts with B, a miller, to carry B's broken crankshaft to its manufacturer for repair. B tells A when they make the contract that the crankshaft is part of B's milling machine and that it must be sent at once, but not that the mill is stopped because B has no replacement. Because A delays in carrying the crankshaft, B loses profit during an additional period while the mill is stopped because of the delay. A is not liable for B's loss of profit. That loss was not foreseeable by A as a probable result of the breach at the time the contract was made because A did not know that the broken crankshaft was necessary for the operation of the mill.”

See Restatement (2d) Contracts § 351, illustration 1 (based on Hadley v. Baxendale, 9 Exch. 341, 156 Eng. Rep. 145 (1854)).
“While we recognize that some cases have applied the economic loss rule to bar recovery where the only loss claimed is economic in nature, see County of Suffolk v. Long Island Lighting Co., 728 F.2d 52, 62 (2d Cir. 1984), and still others have applied that rule to professional malpractice cases, see Joseph v. David M. Schwarz/Architectural Servs., P.C., 957 F. Supp. 1334, 1339-40 (S.D.N.Y. 1997), the better course is to recognize that the rule allows such recovery in the limited class of cases involving liability for the violation of a professional duty. To hold otherwise would in effect bar recovery in many types of malpractice actions.”

Hydro Investors, Inc. v. Trafalgar Power, Inc., 227 F.3d 8, 18 (2d Cir. 2000); contra, 2314 Lincoln Park West Condominium Ass'n v. Mann, Gin, Ebel & Frazier, Ltd., 136 Ill. 2d 302 (Ill. 1990)
Exclusive Remedy of Repair or Replacement

Typically will bar a claim for damages unless the remedy fails of its essential purpose (i.e., the seller or contractor refuses or unreasonably delays in performing repairs or the defect is not repairable).
In most jurisdictions, even where a limited remedy of repair and replacement fails of its essential purpose, limitations on the amount or type of damages will be upheld.

In Valhal Corp. v. Sullivan Engineers, Inc., 44 F.3d 195 (3d Cir.), the United States Court of Appeals for the Third Circuit, applying Pennsylvania law, upheld a limitation of liability clause capping an architectural firm’s liability to the larger of the amount of its fee (in that case $7,000) or $50,000, in a case involving a claim for breach of contract, negligence and gross negligence. The plaintiff client’s claim was for $2,000,000. The court held that “[s]o long as the limitation which is established is reasonable and not so drastic as to remove the incentive to perform with due care, Pennsylvania courts uphold the limitation.” Id. at 204. The court held that in determining reasonableness the relevant comparison is not of cap to amount of claim, but rather cap to expected compensation. Id.
Limitation Against Recovery of Consequential Damages

Limitation of damages provisions, excluding recovery for consequential damages, are generally upheld in commercial agreements. However, a limitation of damages provision will not limit recovery for willful or wanton conduct. Valley Forge Convention & Visitors Bureau v. Visitor’s Services, Inc., 28 F. Supp 2d 947, 950 (E.D. Pa. 1998).