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Negotiating Damages in Construction Disputes

Submitted by Heather F. Shore and Brian Stigler

Heather F. Shore, Esq.

2001 Wyandotte Street
Kansas City, MO 64108
Phone: 816-931-0500
www.sls-law.com

SHAFFER LOMBARDO SHURIN
ATTORNEYS AT LAW

Heather has over two decades of experience handling complex construction, commercial and surety matters ranging in value from $1,000 to $121 million, on some of the most recognizable projects in the country. Having an undergraduate degree in business with a minor in Economics, Heather brings a unique perspective to these practice areas.

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Direct v. Consequential Damages

Direct damages flow directly from the breach, whereas consequential damages refer to the economic harm that is beyond the immediate scope of the contract. *State ex rel. Stovall v. Reliance Ins. Co.*, 278 Kan. 777 (2005).

- *MO*: Direct damages flow "directly and immediately from an act". See *Baybrook Dev. Co. v. Orient Handel, Inc.*, 562 F. Supp. 262, 263 (E.D. Mo. 1983).
- *KS: Direct damages are those which are the direct and proximate result of the wrongful act of which complaint is made. Atchison, T. & S. F. Ry. Co. v. Thomas*, 70 Kan. 409 (1904).

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Direct v. Consequential Damages

Consequential damages are limited to those that are within the contemplation of the parties and are foreseeable to them at the time of contracting.

- *MO*: Consequential damages are "those damages naturally and proximately caused by the commission of the breach and those damages that reasonably could have been contemplated by the defendant at the time of the parties agreement." *Ullrich v. CADCO, Inc.*, 244 S.W.3d 772, 779 (Mo. App. 2008).
- *KS:* Courts generally limit consequential damages to what was foreseeable or contemplated by the parties at the time of entering into the contract. *Neighbors Const. Co. v. Woodland Park at Soldier Creek, LLC*, 48 Kan. App. 2d 33, 55 (2012).

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Betterment

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Betterment

The betterment, or added benefit, doctrine is widely used in construction cases to defend against outrageous damages.

It can be argued in response to claims of breach of contract, as well as claims of negligence.

Example: Repairs that enhance original design standards and thereby increase the project's value or extend the project's original product warranties can constitute "betterment."

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Betterment

- *MO*: Damages awarded should place the injured party in the same position it would have been had the contract been performed, but should not benefit the claimant by providing more than what was promised in the contract. *Stege v. Hoffman*, 822 S.W.2d 517, 521-522 (Mo. App. 1991).

- *KS:* A claimant is not entitled to receive something that is superior or better than what was bargained for, even if the original work is defective. *State ex rel. Stephen v. Wolfenbarger & McCulley, P.A.*, 690 P.2d 380 (Kan. 1984).

In most states, the party defending claims of defect has the burden of proving betterment.

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Non-Monetary Remedies

Competent parties should freely enter into contracts and agree to their own contract terms and to fashion their own remedies, which will be upheld absent fraud or other valid reasons. *See, e.g., Corral v. Rollins Protective Services Co.*,732 P.2d 1260, 1271 (Kan. 1987).

- Do *No Damages for Delay Clauses* limit the freedom to contract your potential monetary remedies?

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Non-Monetary Remedies

- Specific Performance
- Recission
  - -mistake of fact or law
  - -actual or constructive fraud
  - -duress
  - -lack of capacity
- Reformation
  - -mistake or ambiguity in the terms

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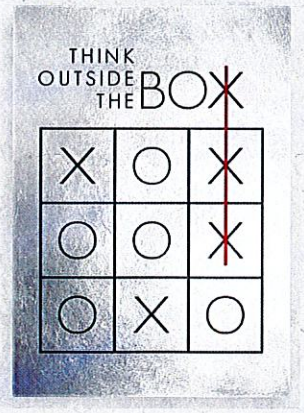
Preserving Business Relationships



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VII. Negotiating Damages in Construction Disputes.

A. Distinguishing Direct and Consequential Damages.

Damages for a breach of contract are generally classified into two categories: direct damages and consequential damages. Direct damages flow directly from the breach, whereas consequential damages refer to the economic harm that is beyond the immediate scope of the contract. *See State ex rel. Stovall v. Reliance Ins. Co.*, 278 Kan. 777 (2005) (explaining the difference between direct and consequential damages).

The Missouri courts define direct "damages" as those which flow "directly and immediately from an act". *See Baybrook Dev. Co. v. Orient Handel, Inc.*, 562 F. Supp. 262, 263 (E.D. Mo. 1983) ("In Missouri an injured party may recover damages for breach of contract [for] . . . actual damages which are the direct and natural consequences of the breach."). *See also Williams Const., Inc. v. Wehr Const., L.L.C.*, 403 S.W.3d 660, 666 (Mo. App. 2012) (quoting *Birdsong v. Bydalek*, 953 S.W.2d 103, 116 (Mo. App. 1997) ("In an action for breach of contract, a plaintiff may recover the benefit of his or her bargain . . ."). *See also Atchison, T. & S. F. Ry. Co. v. Thomas*, 70 Kan. 409 (1904) (recognizing direct damages as those which are the direct and proximate result of the wrongful act of which complaint is made). The Restatement (Second) of Contracts also provides that, "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 . . ." RESTATEMENT (SECOND) OF CONTRACTS § 347 (1981)

In contrast, consequential damages are secondary losses arising from circumstances particular to the specific contract or parties involved. In Kansas, courts generally limit consequential damages to what was foreseeable or contemplated by the parties at the time of entering into the contract. *See Neighbors Const. Co. v. Woodland Park at Soldier Creek, LLC*, 48 Kan. App. 2d 33, 55 (2012). Similarly, Missouri Courts describe consequential damages as "those damages naturally and proximately caused by the commission of the breach and those damages that reasonably could have been contemplated by the defendant at the time of the parties agreement." *Ullrich v. CADCO, Inc.*, 244 S.W.3d 772, 779 (Mo. App. 2008). Therefore, consequential damages are limited to those that are within the contemplation of the parties and are foreseeable to them at the time of contracting.

B. Reducing Damages by Claiming Betterment.

The doctrine of betterment, or added benefit defense, is commonly relied on to mitigate damages in construction cases involving breach of contract actions based on defective work or materials. Courts generally hold that the damages awarded should place the injured party in the same position it would have been had the contract been performed, but should not benefit the claimant by providing more than what was promised in the contract. *Stege v. Hoffman*, 822 S.W.2d 517, 521-522 (Mo. App. 1991). For example, repairs that enhance original design standards and thereby increase the project's value or extend the project's original product warranties can constitute "betterment." Simply stated, betterment "occurs where the plaintiff repairs the defective or non-conforming construction by replacing it with something clearly superior." 5 BRUNER & O'CONNOR CONSTRUCTION LAW § 17:100. *But see L.L. Lewis Constr. v. Adrian*, 142 S.W.3d 255 (Mo. App. 2004) (failing to recognize betterment where additional structural beams had to be

added, but were not in the original bid, because they were needed to correct structural defect); *State ex rel. Stephen v. Wolfenbarger & McCulley, P.A.*, 690 P.2d 380 (Kan. 1984).

Aside from breach of contract cases, betterment may arise under tort claims. As stated in The Restatement (Second) of Torts § 920 betterment arises "[w]hen the defendant's tortious conduct has caused harm to the plaintiff or to his property and in so doing conferred a special benefit to the interest of the plaintiff that was harmed, the value of the benefit conferred is considered in mitigation of damages, to the extent that is equitable." This provision can be used to argue mitigation of the damage, to avoid awarding the claimant more than the benefit it would have received had the contractor properly performed its work.

Regardless of whether betterment arises in the context of a contract claim or tort claim, most courts have placed the burden of proving that the repairs made by the claimant enhanced the value of the property or otherwise resulted in betterment, on the contractor as a defense to damages. *See L.L. Lewis Constr. v. Adrian*, 142 S.W.3d 255 (Mo. App. 2004). *See also Hollingsworth Roofing Co. v. Morrison*, 759 S.W.2d 683, 689 (Tex. App. 1988). However, some courts have held that the claimant has the burden to prove that there was no betterment or added value. *City of Westminster v. Centric-Jones Constructors,* 100 P.3d 472 (Colo. App. 2003), *cert. granted*, 2004 WL 2504512 (Colo. 2004). Because of the divergent positions on the burden of proving betterment and the measure of value of any such betterment, a contractor should consider defining in its contract with the owner what betterment means, which party has the burden of establishing betterment, and the method of calculating the value of the added work or labor if it is determined the owner is responsible for paying the contractor for work performed which was not included in the original contract documents.

C. Non-Monetary Remedies to a Construction Dispute

1. Contracts.

Construction has been described as a high risk, competitive and litigious business. This is true when considering that construction involves bringing together dozens of strangers who are expected to agree on a common goal of constructing a project, in the face of the uncertainties of the weather, Acts of God, the availability of materials and other uncertainties which greatly increase their risks. A risk inherent in construction is that the project will be delayed, and that all parties involved in the construction process will be damaged as a result. A "no damage for delay clause" is now commonly found in construction contracts, as a mechanism for shifting the inevitable risks of delay on a construction project. These are exculpatory clauses that specifically provide that if a subcontractor (or contractor, as the case may be) is delayed, the sole remedy is an extension of time for the work to be completed. A typical "no damages for delay" clause states as follows:

> **3.5 Subcontractor agrees to make no claims against Contractor or Owner should the Schedule not be strictly adhered to, it being understood that Contractor will endeavor to expedite completion of the Project as rapidly as possible.**

Subcontractor specifically acknowledges that extension of time shall be Subcontractor's sole remedy for delay unless the same shall have been caused by Owner's or Contractor's intentional interference with the Subcontract Work, and then only after Subcontractor has provided timely notice to Contractor and Owner has approved such request for extension. In accordance with Subparagraph 4.3 of the General Contract, changes in the scope of the Subcontract Work, suspension of the Subcontract Work, and correction of defective Subcontract Work shall not be construed as intentional interference with Subcontractor's performance

While some states have determined that these contract provisions are not enforceable as a matter of public policy and for other legal reasons, most states start with a presumption that the clause is valid and enforceable, if it is clearly drafted. For example, in Kansas, the Kansas Supreme Court enforced a damages limitation provision that, while not precisely the same as a run-of-the-mill "no damages for delay" clause, generally had the same effect of limiting the contractor's damages. *Kansas City Structural Steel Co. v. L.G. Barcus & Sons, Inc.,* 217 Kan. 88, 535 P.2d 419 (1975). Since that holding, the Kansas courts have uniformly held that competent parties may freely enter into contracts and agree to their own contract terms and to fashion their own remedies, which will be upheld absent fraud or other valid reasons. *See, e.g., Corral v. Rollins Protective Services Co.*,732 P.2d 1260, 1271 (Kan. 1987) (finding "no damage for delay" clauses are valid and enforceable so long as they are "fairly and knowingly entered into and if not in violation of

other provisions of law"); *The Law Co., Inc. v. Mohawk Constr. and Supply Co.,* 523 F. Supp. 2d 1276 (D. Kan. 2007) (holding that neither waiver nor estoppel barred a valid, no-damages-for-delay clause in construction contracts). Other courts have routinely upheld similar "no damages for delay clauses". *See, e.g., Huen New York, Inc. v. Board of Education of Clinton Central School District*, 2009 N.Y. App. Div. LEXIS 8113, at 3-4 (N.Y. Sup. Ct. App. Div. 4th Dept. 2009) (barring recovery for delay damages claimed by Contractor because the exclusive remedy for delay was an extension of time, and the architect had no authority to determine plaintiff's claim for delay damages because that claim was precluded by the no damage for delay clause).

To overcome the enforceability of a "no damages for delay clause," the contractor should focus on proving that the owner has actively interfered in the construction project and the interference has caused the delay. In doing so, the contractor must establish that the owner committed an affirmative, willful act that unreasonably interfered with the contractor's performance of the contract. Typically, it is not necessary to show bad faith; however, active interference requires more than the owner's error in judgment, being difficult to deal with, or being lackadaisical. Instead, the evidence must establish the owner's gross negligence or intentional unwillingness to cooperate with the contractor. *Tricon Kent Co. v. Lafarge North America, Inc.*, 186 P.3d 155, (Colo. App. 2008). *See also Weitz Co. v. Alberici Constructors, Inc.*, 2009 U.S. Dist. LEXIS 3235, at 3 (Nebr. 2009) (evidence showed that the delays were entirely beyond the contractor's control and solely within the developer/owner's control).

E. Preserving Business Relationships While Negotiating Damages.

"Think Outside the Box."