BREACH OF CONTRACT DAMAGES IN CONSTRUCTION CASES

By Lonnie D. Johnson

In construction cases, there are three general categories of contract damages: 1) damages for failure to perform; 2) damages for defective workmanship, and; 3) schedule related damages. This article reviews the cases and basic legal principals applicable to theses three types of construction contract claims.

A. FAILURE TO PERFORM

Failure to perform cases arise from several scenarios. An owner may contract with a general contractor only to later change its mind and give the job to another company; or the general contractor may do the same to a subcontractor. Likewise, a contractor may contract with an owner or another contractor to perform work, but then refuse to begin or fully complete the project. Such failure to perform cases are governed by general principals of contract law.

Indiana law generally provides damages for a breach of a construction contract amounting to the "benefit of the bargain". *Berkel & Company Contractors, Inc. v. Palm & Associates*, 814 N.E.2d 649, 660 (Ind. Ct. App. 2004); *INS Investigations Bureau, Inc. v. Lee*, 784 N.E.2d 566 (Ind. Ct. App. 2003). Such a benefit is determined by the reasonable cost of completion of the contract or those damages actually suffered, and reasonable expenses incurred as a natural consequence of the breach, including, "damages for delays, for economic loss resulting from breach of contract, for loss of full use and enjoyment of property occasioned by breach, and for probable cost for future repairs". *Orto v. Jackson*, 413 N.E.2d 273, 278 (Ind. Ct. App. 1980); *See Fowler v. Campbell*, 612 N.E.2d 596, 603 (Ind. Ct. App. 1993); *J.E. Pierce v. Drees*, 607 N.E.2d

726, 729 (Ind. Ct. App. 1993); *Johnson-Johnson v. Farah*, 108 N.E.2d 638, 639 (Ind. Ct. App. 1952); *Merrillvill Conservancy Dist. v. Atlas Excavating*, 764 N.E.2d 718, 724 (Ind. Ct. App. 1940). These costs can include any fairly defined and reasonably measurable standards, such as, "cost of repair, market value, established experience, rental value, loss of use, loss of profits, or direct inference from known circumstances." *Fowler*, 612 N.E.2d at 603. In general, the court acts to return the injured party to the position it would be in had the breach not occurred, but may not act to place the party in a "better position than it would have enjoyed had the breach not occurred." *Whitaker v. Brunner*, 814 N.E.2d 288, 296 (Ind. Ct. App. 2004) ("When injured by a breach of contract, a party's recovery is limited to the loss actually suffered. Such party may not be placed in a better position than he or she would have enjoyed if the breach had not occurred."); *Abbey Villas Development Corp. v. Site Contractors, Inc.*, 716 N.E.2d 91, 102 (Ind. Ct. App. 1999); *Sheppard v. Smith*, 749 N.E.2d 609 (Ind. Ct. App. 2001). These damages are measured according to an objective test of what a reasonable person would foresee as the potential liability stemming from the contractual relationship. *Fairfield Development, Inc. v. Georgetown Woods Sr. Apartments Ltd. Partnership*, 768 N.E.2d 463, 474 (Ind. Ct. App. 2002) ("Generally, the measure of damages for breach of contract is either such damages as may fairly and reasonably be considered as arising naturally from the breach itself, or as may be reasonably supposed to have been within the contemplation of the parties at the time they entered into the contract as a probable result of the breach."). However, an injured party must act to mitigate any damage incurred to the extent reasonable. *Berkel*, 814 N.E.2d at 660; *J.E. Pierce*, 607 N.E.2d at 729. Failure to

mitigate must be proven by the breaching party by a preponderance of the evidence as an affirmative defense. *Id.*

An injured party may also seek damages for consequential damages such as lost profits caused by the breach, assuming "evidence is sufficient to allow the trier of fact to estimate the amount with a reasonable degree of certainty of certainty and exactness". *Clark's Pork Farms v. Sand Livestock Systems, Inc.*, 563 N.E.2d 1292, 1298 (Ind. Ct. App. 1990) (May receive damages for the lost profits as well as cost to bring structure into accordance with contract); *See Berkel,* 814 N.E.2d at 659; *Orto,* 413 N.E.2d at 278; *Uebelhack Equipment, Inc. v. Garrett Bros., Inc.*, 408 N.E.2d 136, 140 (Ind. Ct. App. 1980). "Lost profits need not be proven with mathematical certainty, the evidence must be, however, sufficient to allow a trier of fact to estimate the actual amount of profits lost with a reasonable degree of certainty and exactness." *Uebelhack Equipment,* 408 N.E.2d at 140.

When legal damages are insufficient to genuinely remedy the injury caused by the breach, specific performance is a possible, but extremely rare, remedy. *Kesler v. Marshall,* 792 N.E.2d 893, 896 (Ind. Ct. App. 2004). However, specific performance is considered an equitable remedy, which may not be granted when an adequate method of relief exists in law which serves to compensate the injured party. *Id.* at 897, *Porter v. Bankers Trust Co. of California, N.A.*, 773 N.E.2d, 901, 908 (Ind. Ct. App. 2002). Thus, only when legal damages fail to adequately or effectively remedy the harm caused by the breach may the court impose a remedy of specific performance. *Id.* ("Where substantial justice can be accomplished by following the law, and the parties actions are clearly governed by rules of law, equity follows the law.")

Additionally, there is a possible available remedy of "total economic loss" damages in very specific and rare circumstances, in which damages are determined by, "subtracting the contract amount from the total cost of performance." *Northrop Corp. v. General Motors Corp.*, 807 N.E.2d 70, 101 (Ind. Ct. App. 2004). It is unclear whether Indiana law would allow this measure of damages, as the only case decided in Indiana allowing such damages involved an application of California law. *Id.* However, assuming total cost damages are allowed in Indiana, a court may only apply total cost damages through the application of a four-part test. *Id.* "A jury may be permitted to award damages under the total cost methodology, but the plaintiff must 'establish (1) the impracticality of proving actual losses directly; (2) the plaintiff's bid was reasonable; (3) its actual costs were reasonable; and (4) it was not responsible for the added costs.'" *Id.*, citing *Amelco Electric v. City of Thousand Oaks*, 38 P.3d 1120, 1129 (Cal. 2002).

B. DEFECTIVE PERFORMANCE

The overwhelming majority of claims for breach of construction contract involve cases where a contractor fully performs the contract but the work allegedly contains defects.

The damages for a breach of a construction contract due to defects in the performance of the contract are measured as the cost to reasonably repair the defective work and bring the work up to the level required in the contract. *J.E. Pierce*, 607 N.E.2d at 729; *Gough Construction Company, Inc. v. Tri-State Supply Company*, 493 N.E.2d 1283, 1284-85 (Ind. Ct. App. 1986); *Sanborn Electric Company v. Bloomington Athletic Club*, 433 N.E.2d 81, 87 (Ind. Ct. App. 1982). Additional damages may also arise in defective performance claims, such as the additional costs to maintain or repair defective

structures that would not exist had the work been completed adequately. *4-D Buildings, Inc. v. Palmore*, 688 N.E.2d 918, 921 (Ind. Ct. App. 1997) (Costs for concrete sealer and a heat source for repair crews forced to work in undesirable conditions held to be valid remedies for defective construction breach.) However, if repairs to the work are either not feasible or would constitute an "economic waste", the damages are the difference between the value of the contracted work had it been completed in accordance with the contract subtracted from the value of the work as currently done. *J.E. Pierce*, 607 N.E.2d at 729; *Willie's Construction Company, Inc. v. Baker*, 596 N.E.2d 958, 962 (Ind. Ct. App. 1992); *Gough Construction*, 493 N.E.2d at 1284-85 (Waste exists when, "compliance with original contract would require that a substantial portion of the work be 'undone'"); *James I. Barnes Construction Co. v. Washington Township of Starke County*, 184 N.E.2d 763, 766 (Ind. Ct. App. 1962). The measure for economic waste is whether the repairs would require the removal of a substantial portion of the structure to be rebuilt, in such a manner as that it would be more efficient to start the entire work over. *Willie's Construction*, 596 N.E.2d at 962 ("Economic waste exists only when the cost to repair measure for damages would result in unreasonable duplication of effort. Further, economic waste is not present and the difference in value measure cannot be used unless the building would be substantially destroyed by completely remedying the defects." citing, *Fairway Builders, Inc. v. Malouf Towers Rental Co., Inc.* 603 P.2d 513, 524-525 (Ariz. 1979)). The burden of showing economic waste is on the breaching party, who must show that it is impossible to remedy the defects without substantial duplication of the work, and thus damages should be limited to the difference in value of the work as contracted and the work as performed. *Willie's Construction*, 596 N.E.2d at 962.

C. SCHEDULE RELATED DAMAGES

Timely completion of large construction projects depends upon the correct sequencing and interfacing of the work of numerous contractors and trades. As the adage goes, time is money, and when a project strays from the critical path, delays and attempts to regain schedule slippage alter time and foil cost estimates, causing companies to incur losses. Likewise, when performance is wrongfully extended beyond the contract date, an owner may sustain losses caused by the delay, and bring suit to recover damages. Delay claims are filed by contractors to recover the additional expenses of performing on the job site longer than estimated due to the fault of the owner, architect or another contractor. At the other end of the spectrum, changes in the scope and timing of the project may compel contractors to perform at a quicker pace than anticipated. So called "acceleration claims" allow a contractor to recover the costs associated with performing at a more rapid pace than estimated. There are two types of acceleration claims: actual and constructive.

1. Owner Delay Claims

If a contractor is at fault for a delay in construction of the project, the owner may seek redress under several damage theories. If the breach of the contract stems from a delay of the completion time, damages are measured as value of the use of the structure during the time the plaintiff was deprived of it, generally arising as the fair rental value of the structure for the time the injury existed. *Johnson-Johnson, Inc.*, 108 N.E.2d at 639 (Ind. Ct. App. 1952) ("The general rule of law is well settled that the measure of damages for breach of a construction contract is the reasonable cost of completion, and that in event of long and unreasonable delay damages for loss of use may, under some

circumstances, also be awarded."); *Cleveland, C., C. & St. L. Ry. Co. v. Joyce*, 103 N.E. 354, 357 (Ind. Ct. App. 1913); *Jay Clutter Custom Digging v. English*, 393 N.E.2d 230, 233 (Ind. Ct. App. 1979); *Berkey & Gay Furniture Co. v. Hascall*, 24 N.E. 336, 338 (Ind. 1980) (Damages limited to "actual loss", which is the loss of use of a contracted object for the time of the breaching delay); *Singer v. Farnsworth*, 2 Ind. 597, *2 (1851) (Damages limited to use of product for the time delay occurred). Additionally, one may seek damages amounting to those costs arising directly from the delay, such as the rental of alternate premises or equipment. *Chicago College of Osteopathic Medicine v. George A. Fuller Co.*, 776 F.2d 198, 205 (7th Cir. 1985) (Assuming they could show costs with adequate specificity, subcontractor would have been able recover for the rental value of tools and equipment left unused during delay caused by main contractor.); *Cleveland, C., C. & St. L. Ry. Co. v. Joyce*, 103 N.E. at 357. These costs must be, "susceptible of ascertainment in some manner other than by mere conjecture, speculation or surmise. *Jay Clutter*, 393 N.E.2d at 233". Thus, awards for lost profits are looked upon warily by the court, as they are not reasonably certain enough to base an award of damages upon. *Id.* at 233-34. (loss of corn crop and resulting profits not reasonably certain to be caused by delay, and thus not viable as computation of damages.); *Berkey*, 24 N.E. at 338. If the specific contracted item is unusable at the time of the delay, damages for delay of completion are limited to the interest bearing ability of the funds already paid for the completion of the project, as rental or usage values are nil. *Wood v. Joliet Gaslight Co.*, 111 F. 463 (7th Cir. 1901) (When item at issue is only usable during winter months, in the absence of evidence of special damages, defendant is entitled to recoup, as damages against the unpaid balance of the contract price, a sum at least equal to the legal interest

on the monies and property invested in the project for those times when the object would have been unusable).

2. Contractor Delay Claims

There are three basic types of claims by which a contractor can recover his damages and additional costs incurred on a project. First, the contractor may bring a traditional delay claim against another contractor or owner whose acts or omissions caused the contractor's work to be delayed. *Indiana & Michigan Elec. Co. v. Terre Haute Indus., Inc.*, 507 N.E.2d 588, 602 (Ind. Ct. App. 1987). Proof that the defendant caused the delay is the crucial element of a delay claim. *See Id.*; *see also Amp-Rite Elec. Co. v. Wheaton Sanitary Dist.*, 580 N.E.2d 622, 673 (Ill. App. Ct. 1991); *S. Leo Harmonay, Inc. v. Binks Mfg. Co.*, 597 F. Supp. 1014, 1026 (S.D. N.Y. 1984); *McNamara Construction of Manitoba, Ltd. v. United States*, 509 F.2d 1166, 1169 (Ct. Cl. 1975). If the plaintiff can carry the burden of proving its performance was wrongfully delayed by the defendant, then plaintiff can recover the accumulated additional cost of performance occurring as of the date that the delay commenced. *See Indiana & Michigan Electric Co.*, 507 N.E.2d at 602; *see also Amp-Rite Elec. Co. v. Wheaton Sanitary Dist.*, 580 N.E.2d at 673; *Peter Scalamandre & Sons, Inc. v. Village Dock, Inc.*, 589 N.Y.S.2d 191, 191 (N.Y. App. Div. 1992) ("A contractor wrongfully delayed by its employer must establish the extent to which its costs were increased by the improper conduct, and its recovery will be limited to damages actually sustained").

Generally, a contractor is entitled to recover any damages for any delay caused by the Owner. *See Indiana & Michigan Electric Company vs. Terre Haute Industries, Inc.*, 507 N.E.2d at 588. In pursuing a delay claim, a contractor generally can recover

overhead costs attributable to the operation of a field office during the period of delay. *See Guy James Construction Company vs. Trinity Industries, Inc.*, 644 F.2d 525 (5th Cir. 1981). In certain circumstances, home office overhead can be recovered when properly attributable to a specific construction project. *See Complete General Construction Company vs. Ohio Department of Transportation*, 760 N.E.2d 364 (Ohio 2002). There are various methods utilized by courts to calculate and allocate overhead expenses, with the so-called Eichleay formula being the general rule. *See Aetna Casualty & Surety Company vs. Doleac Electric Company*, 471 Southern 2d. 325 (Miss. 1985). However, as with any breach of contract action, the contractor has a duty to mitigate damages and must take other work, if able, to minimize the potential damages caused by a construction delay. *Complete General*, 760 N.E.2d at 370.

3. Acceleration Claims

Inducement is the cornerstone of a claim for acceleration, and absent inducement, a mere acceleration does not entitle a party to recover damages. *See Dep't of Transp. v. Anjo Constr. Co.*, 666 A.2d 753, 757 (Pa. Commw. Ct. 1995). Acceleration claims arise when a contractor acts in such a manner as to induce the contracted party to complete the project ahead of the scheduled completion date. *Id.* The mere existence of acceleration in performance is insufficient to establish that the other party acted to induce the acceleration, and absent evidence to the contrary, the acceleration is presumed to be a voluntary action. *Stelko Elec., Inc. v. Taylor Community Schools Building Corp.*, 826 N.E.2d 152, 158 (Ind. Ct. App. 2005).

With actual acceleration claims, the period for performance relied upon in cost estimating is compressed because either the original target date for completion is

advanced, the start date is delayed with the completion date remaining fixed, or the scope of the work to be performed within the fixed period is expanded. An order to accelerate may be explicitly stated in the form of a command to complete the project at a time ahead of that provided by the contract, or may be a constructive order. *Anjo Constr. Co.*, 666 A.2d at 757. A constructive order occurs when an owner or contractor behaves in such a way as to convey the message of acceleration to a contractor without the use of a direct command. *Norair Engineering Co. v. United States,* 666 F.2d 546. The determination of whether a contractor's actions constitute a constructive order is a question of law. *Id*.; *See also Pennsylvania Liquor Control Board v. City of Philadelphia*, 333 A.2d 497 (Pa. Cmmw. Ct. 1975). In *Tombigbee Constructors*, a government "request" to perform a task in a manner different from that agreed on in the terms of the contract was deemed to be equivalent to an order that the scope of the project be altered. 420 F.2d 1037, 1046 (Ct. Cl. 1970).

Every actual legal theory or claim has its "constructive" counterpart. Constructive acceleration claims provide relief for contractors where both the initial time-frame and the scope of work to be performed have remained the same but circumstances beyond the contractor's control support a finding that performance was constructively accelerated. A constructive acceleration claim differs from constructive acceleration orders discussed above, which may be imposed to trigger an actual claim. While inducement is the cornerstone of an actual acceleration claim, the wrongful refusal of a rightful request for an extension for time to complete work is the hallmark of a constructive acceleration claim.

Typical construction contracts allow a contractor faced with unavoidable delays an extension of the contract performance date. *Sherman R. Smoot Co. v. Ohio Dept. of Adm. Serv.* 736 N.E.2d 69, 78 (Ohio Ct. App. 2000). The failure of the owner or prime contractor to grant a justified extension, instead holding to the original timeline of the project, gives rise to a constructive acceleration claim. *Id.* The five elements for a successful constructive acceleration claim are: "(1) the contractor experienced an excusable delay entitling it to a time extension, (2) the contractor properly requested the extension, (3) the project owner failed or refused to grant the requested extension, (4) the project owner demanded that the project be completed by the original completion date despite the excusable delay, and (5) the contractor actually accelerated the work in order to complete the project by the original completion date and incurred costs as a result." *Id.*; *Envirotech Corp. v. Tenn. Valley Auth.*, 715 F.Supp. 190,192 (W.D.Ky. 1988).

Excusable Delay Entitling a Contracting Party to a Time Extension

Excusable delays in the context of a constructive acceleration claim are creations of *force majeure* contract clauses which allow a contracting party to avoid contract damages where unavoidable circumstances necessitate the project taking longer to complete than initially estimated. *Tombigbee Constructors,* 420 F.2d at 1046. The most obvious and common subject of these clauses is the so-called "act of God" delay, which a contracting party has no ability to control, avoid, or foresee. The existence of an unavoidable delay is a question of law. *Norfolk Southern Corp., Norfolk Southern Tower v. Main Financial Associates, L.L.C.* 2001 WL 34038611, *3 (Va. Cir. Ct. 2001). The burden of proving the existence of such a delay is on the party alleging its existence. *See In re Bushnell*, 273 B.R. 359, *364 (Bkrtcy.D.Vt. 2001).

It is important to emphasize that excusable delay clauses do not shift the burden of the losses incurred by such a delay to the other party. *Id.* at 1037; *Mcnamara Contr. of Manitoba, Ltd. v. United States*, 509 F.2d 1166, 1170 (Ct. Cl. 1975). Instead, such clauses only allow the delayed party an extension of the completion date in an effort to avoid potential breach of contract liability for failure to complete the job on the original contract schedule. *Tombigbee Constructors,* 420 F.2d at 1037. Such clauses do not include delays that, while unavoidable, are foreseeable. It is anticipated that a prudent contractor will construct estimates with these foreseeable delays in mind. If a contractor bears the risk of loss over a subject in the contract, that subject cannot be the basis for an unavoidable delay by that party. *See Mt. Olivet Baptist Church, Inc. v. Mid-State Builders, Inc*., 1985 WL 10493 (Ohio Ct. App. 1985). Thus, for example, lower than estimated productivity in and of itself is not considered an unavoidable delay, as a contractor is deemed to have control over its own employees and construction methods such that it bears the risk of low productivity. *Id.* at *5. *Force majeure* clauses are triggered by a "cause" not an "effect." Thus, to be entitled to relief, the contractor must identify a specific "cause" of the performance difficulty which is recognized as clearly beyond the contractor's control.

b. Proper Request for an Extension

A party experiencing an excusable delay has the burden to affirmatively seek an extension from the other contracting party. In the event that a contractor accelerates performance on the project to meet the initial start date despite an excusable delay without requesting relief, the acceleration is deemed voluntary and the costs of the acceleration are not recoverable. *See generally, Nello L. Teer Co. v. Washington Metro.*

Area Transit Auth., 695 F. Supp. 583 (D.C. 1988); *see also Envirotech Corp.* 715 F. Supp. at 190; 5 Phillip L. Bruner & Patrick J. O'Connor, Jr., BRUNER AND O'CONNOR ON CONSTRUCTION LAW § 15:94 (2004).

Construction contracts usually require a written request for an extension. If this request is unambiguously expressed in the contract, then the failure of a delayed party to submit a written request bars a constructive acceleration claim. *See Johnson Controls, Inc. v. Nat'l Valve and Mfg. Co.*, 569 F. Supp. 758 (E.D. Okla. 1983) (granting summary judgment against subcontractor on acceleration claim because of failure to comply with requirement of written request, even where general contractor caused subcontractor's delays); *see also, A. Beecher Greenman Constr. Corp. v. Incorporated Village of Northrop*, 619 N.Y.S.2d 293 (N.Y. App. Div. 1994) (finding liquidated damages could be assessed against contractor for later completion where contractor had not satisfied contractual requirement of written request for extension of time).

c. Wrongful Refusal of a Proper Request

A wrongful refusal can only stem from a proper request for an extension, with the sufficiency of the request measured at the time of request, not at the time of trial. *See, e.g., Nello L. Teer Co.,* 695 F.Supp. at 590-91 (owner's refusal of extension request that contained only insufficient data at the time of request deemed not a wrongful refusal, as the information contained in the request did not allow the owner to make a proper determination concerning the extension at that time). If an extension is not requested or is requested in a manner inconsistent with the terms of the contract, a refusal of the extension, is not wrongful. *Id.*

Lastly, it must be emphasized that it is a well-settled legal principle that efforts to induce performance of the contract by the original target date do not give rise to an acceleration claim when the cause of the delay is solely the actions of the performing party. *Siefford v. Hous. Auth. of the City of Humboldt*, 223 N.W.2d 816, 819 (Neb. 1974).

Damages for acceleration claims are limited to the additional costs incurred to complete the project pursuant to the shortened schedule beginning on the date the acceleration order was issued or when a proper request for an extension was denied. *Anjo Constr. Co.*, 666 A.2d at 757. These costs may include such amounts as the hiring costs and salaries of additional workers, overtime pay increases, additional costs of materials due to the shortened time span, etc. *Anjo Const. Co.*, 666 A.2d at 757-58; *Siefford*, 223 N.W.2d at 819. Consequential damages are not recoverable in an acceleration claim. *Sherman R. Smoot Co.*, 736 N.E.2d at 78; *Anjo Const. Co.*, 666 A.2d at 757. Damages may be measured either through a "total cost" measurement, where the award is the difference between the actual costs of the project and the projected costs, or by a measurement of the precise amount of new costs incurred as a result of the acceleration. *John F. Harkins Co., Inc. v. School Dist. of Philadelphia*, 460 A.2d 260, 265 (Pa. Super. 1983). "Total cost" damages can only be awarded if the party requesting the damages can show that its initial estimates of costs were accurate. *Id*.; *See also Wunderlich Contracting Co. v. United States*, 351 F.2d 956, (Ct. Cl. 1965); (total cost damages are valid, but the reasonableness of the contractor's estimate is a question of fact in each case); *Exton Drive-In, Inc. v. Home Indemnity Co.*, 436 Pa. 480, 261 A.2d 319, 324

(1970) (approving of total cost damages even in absence of mathematical certainty, so long as the measurements are reasonable).