

THEORIES OF RECOVERY

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I. HISTORICAL INTRODUCTION

To understand the available theories of damage recovery under modern construction law, one must understand how our current law evolved. Construction law seems to have existed long before money itself was invented, so many centuries passed in which there was no need for rules on how to quantify monetary damages for breach of contract. If an early builder failed to do his work properly, the aggrieved parties were apparently content to choose between requiring corrective work or taking some form of personal revenge.

Around 1780 B.C., King Hammurabi¹ promulgated what is often said to be the oldest surviving codification of construction law. It included some of the following remedial clauses:

If a builder build a house for someone, and does not construct it properly, and the house that he built fall in and kill its owner, then that builder shall be put to death.

If it kill the son of the owner, the son of that builder shall be put to death.

If it kill a slave of the owner, then he shall pay slave for slave to the owner of the house.

1. Hammurabi was the sixth king of the Amorite Dynasty in Old Babylon.

If it ruin goods, he shall make compensation for all that has been ruined, and inasmuch as he did not construct properly this house which he built and it fell, he shall re-erect the house from his own means.

If a builder build a house for someone, even though he has not yet completed it; if then the walls seem toppling, the builder must make the walls solid from his own means.²

Over the centuries, however, builders were eventually successful in dissuading owners from using the death penalty as a method of resolving construction disputes. By the sixth century B.C., the dynasty of King Croesus³ had popularized the use of coinage as a medium of exchange, and it became increasingly accepted that construction errors and omissions should be redressed through money damages.⁴

The word “damage” derives from the Latin word *damnum*, referring to a loss suffered. An older edition of *Black’s Law Dictionary* defined “damages” as “[a] pecuniary compensation or indemnity, which may be recovered in the courts by any person who has suffered loss, detriment, or injury, whether to his person, property, or rights, through the unlawful act or omission or negligence of another.”⁵

A more recent edition explains damages more simply as “money claimed by, or ordered to be paid to, a person as compensation for loss or injury.”⁶ In other words, damages are a monetary amount by which a court or arbitrator quantifies a payment owed by one party to another.

2. See Hammurabi Code §§ 229–233 at <http://avalon.law.yale.edu/ancient/hamframe.asp>.

3. Croesus was king of Lydia until he misinterpreted a Delphic oracle and destroyed his own kingdom by attacking his more powerful Persian neighbors. His great wealth gave rise to the saying “as rich as Croesus.” See <http://ancienthistory.about.com/od/croesus/a/croesus.htm>.

4. Arthur Corbin aptly summarized the role of contract law in replacing the more primitive system of personal revenge:

There is more than one purpose underlying the rules of law that provide for the giving of damages for breach of contract. One of the ends to be obtained is, without doubt, the keeping of the peace. The party injured by the breach has a sense of grievance. In the absence of a public remedy, he would do his best to redress his own wrong. This means private war, with all of the resulting harm that it entails to the interests of other people.

ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 1002, at 29 (interim ed. 2002) [hereinafter CORBIN].

5. BLACK’S LAW DICTIONARY 499 (3d ed. 1933).

6. BLACK’S LAW DICTIONARY “damages” (9th ed. 2009), available at Westlaw BLACKS [hereinafter BLACK’S LAW DICTIONARY].

II. COMPENSATORY DAMAGES

Inherent in the foregoing definitions is a notion that there are some injuries for which the law of contracts awards no damages. The Romans referred to this as *damnum sine injuria*,⁷ i.e., damages without actionable wrongful act. To the extent that this principle survives, civil litigants in construction cases are sometimes surprised and disappointed to learn that they may not recover compensation for the emotional damages that they in fact may suffer from another party's breach of contract.

It is sometimes noted as an ironic feature of the common law that a momentary unintentional act of negligence can expose a tortfeasor to broader liability than arises from an intentional breach by a person who is contractually bound to another. In general, however, awards of pecuniary damages (as distinguished from specific performance) in construction contract cases are limited to recovery based upon economic losses that can be established by a preponderance of evidence.

Arthur Corbin explains that the need for flexible legal rules is sometimes at odds with the need for uniformity in assessing contract damages:

The purpose of awarding damages is always said to be compensation for harm done. The effort is made to put the injured party in as good a position as he would have been put by full performance of the contract, at the least cost to the defendant and without charging him with harms that he had no sufficient reason to foresee when he made the contract. The various difficulties involved in this effort frequently make it impracticable to attain its purpose with any near approach to exactness.

The rules of law governing the recovery of damages for breach of contract are very flexible. Their application in the infinite number of situations that arise is beyond question variable and uncertain. Even more than in the case of other rules of law, they must be regarded merely as guides to the court, leaving much to the individual feeling of the court created by the special circumstances of the particular case. In spite of the difficulties involved, the courts have actually achieved a considerable degree of uniformity. . . .⁸

7. Also referred to as *damnum absque injuria*.

8. CORBIN § 1002, at 27-28.

Traditionally, courts have viewed the law of contract damages as protecting three interests of an injured party. The “expectation interest,” “reliance interest,” and “restitution interest” will each be discussed in this chapter.⁹

III. FORESEEABILITY

Another fundamental principle is that damages are recoverable only if they are within the scope of what the breaching party “knew or should have known when the contract was made.”¹⁰ The 19th-century English decision in *Hadley v. Baxendale*¹¹ is often cited as establishing this “foreseeability” limitation. The Restatement (Second) of Contracts explains that “[d]amages 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.”¹²

In other words, the breaching party may be liable both for the types of damages that are likely to result from a breach “in the ordinary course of events”¹³ and for the particular types of damage of which “the party in breach had reason to know.”¹⁴ Especially in breach of contract claims alleging common law damages against the federal government, remote damages will be disallowed.¹⁵

In a construction context, for example, a defaulting subcontractor or supplier will presumably foresee that its nonperformance can expose the prime contractor to liquidated damages that are contractually payable to the owner. Conversely, an owner who has received pre-bid submissions outlining the contractor’s planned methods and sequences of work may have specific knowledge about ways in which the contractor would be adversely affected if the project is unreasonably changed or delayed. Of course, a party’s liability for some of these

9. See RESTATEMENT (SECOND) OF CONTRACTS § 344 (1981); Ralph C. Nash & John Cibinic, *Breach-of-Contract Damages: Expectation, Reliance, or Restitution*, 10 NASH & CIBINIC REPORT 51 (October 2001).

10. BLACK’S LAW DICTIONARY “damages—foreseeable damages”; see also JUSTIN SWEET, LEGAL ASPECTS OF ARCHITECTURE, ENGINEERING AND THE CONSTRUCTION PROCESS § 6.06(C), at 47–48 (8th ed. 2009).

11. 9 Ex. 341, 156 Eng. Rep. 145 (1854).

12. RESTATEMENT (SECOND) OF CONTRACTS § 351(1) (1981).

13. *Id.* § 351(2)(a); see also *Am. Capital Corp. v. F.D.I.C.*, 472 F.3d 859, 867 (Fed. Cir. 2006); *Stovall v. United States*, 94 Fed. Cl. 336, 353 (2010); CORBIN §§ 1007 *et seq.*

14. *Am. Capital Corp.*, *supra* note 13, 472 F.3d at 867; *Landmark Land Co. v. FDIC*, 256 F.3d 1365, 1378 (Fed. Cir. 2001); *Stovall*, *supra* note 13, 94 Fed. Cl. at 353; RESTATEMENT (SECOND) OF CONTRACTS § 351(2)(b) (1981).

15. See, e.g., *San Carlos Irrigation & Drainage Dist. v. United States*, 111 F.3d 1557 (Fed. Cir. 1997); *Wells Fargo Bank N.A. v. United States*, 88 F.3d 1012 (Fed. Cir. 1996); *Englewood Terrace Ltd. P’ship v. United States*, 94 Fed. Cl. 116, 130–34 (2010).

foreseeable damages may in some cases be limited effectively by contract, as will be discussed further in Chapter 10 of this book.

The permissible theories of damage recovery in U.S. construction litigation often find roots in the English courts of law and equity. The most common theories of damage recovery are reviewed below.

IV. RELIANCE DAMAGES

When a construction or supply contract is formed and then breached, the non-breaching party is generally entitled to recover its costs incurred in reasonable reliance on the agreement. This is the principle of “reliance damages.”

Black’s Law Dictionary defines reliance damages as “damages awarded for losses incurred by the plaintiff in reliance on the contract.”¹⁶ The Restatement (Second) of Contracts summarizes this principle by stating that “the injured party has a right to damages based on his reliance interest, including expenditures made in preparation for performance or in performance, less any loss that the party in breach can prove with reasonable certainty the injured party would have suffered had the contract been performed.”¹⁷

A party’s “reliance interest” is defined as its “interest in being reimbursed for loss caused by reliance on the contract by being put in as good a position as he would have been in had the contract not been made.”¹⁸ In explanatory Comment (a), the Restatement adds:

If the injured party was to supply services such as erecting a building, for example, the difference between loss in value of the other party’s performance and the cost or other loss avoided by the injured party will be equal to the cost of the injured party’s expenditures in reliance, up to the time of breach, plus the profit that would have been made had the contract been fully performed.¹⁹

These principles are often applied in construction disputes, especially when a project is terminated before it achieves completion. In some cases, termination occurs before any actual work is performed at the designated construction site. For example, an owner may award a construction contract but fail to issue a notice to proceed at the site. In that case, the construction contractor would have a claim for costs reasonably incurred in preparing for the job. A contractor might incur such costs for ordering materials, making nonrefundable deposits

16. BLACK’S LAW DICTIONARY “reliance damages.”

17. RESTATEMENT (SECOND) OF CONTRACTS § 349 (1981).

18. *Id.* § 344(b).

19. *Id.* § 349, cmt. a.

for shipment of materials, preparing permit applications or paying permit fees, creating a file system for project records, or specially fitting equipment for the contemplated project.

A construction supplier may start to incur reliance costs as soon as it begins to set aside shop time for manufacture of required equipment or starts to create special dies, molds, or forms that are uniquely designed for the job in question. The manufacturing of required equipment often begins in reliance on a purchase order, even though on-site construction has not yet started. Thus, even if a purchase order is canceled prior to the first delivery, the supplier may already have incurred or committed to substantial costs.

Once construction has started, claims for reliance damages will generally extend to all costs incurred in performance of the work. As suggested by the Restatement, however, there are a variety of limitations on a claimant's right to recover the costs that it incurred in "reliance" on a contract. A nonexhaustive list of those limitations might include

- Offset for the claimant's savings if the breaching party can prove that the plaintiff would have lost money in completing the contract.
- Offset for costs that can be avoided through reasonable mitigation by the nonbreaching party (for example, reusing materials that can readily be used on other work or sold at market).
- Possible offset for costs that the breaching party can show to have been unreasonable—partly on the theory that unreasonable expenditures are beyond the scope of reasonable foreseeability, as discussed earlier in this chapter.²⁰

It should be noted that in some circumstances, a provider of labor, materials, or equipment may have a claim for reliance damages even before it has a written contract. If a prime construction contract has been awarded under circumstances where the prime contractor is obliged to utilize certain subcontractors or suppliers whose prices were incorporated into the final bid, those subcontractors and suppliers may reasonably argue that they thereafter have a right to incur costs in reliance on the expectation of receiving a contract under which they will ultimately be reimbursed.²¹ A plaintiff's entitlement to reliance damages

20. See *Landmark*, *supra* note 14, 256 F.3d at 1378 ("In order to be entitled to reliance damages, a plaintiff must prove that both the magnitude and type of damages were foreseeable."). But see *Am. Sav. Bank, F.A. v. United States*, 98 Fed. Cl. 291 (2011) (noting that the Federal Circuit in *Anchor Sav. Bank v. United States*, 597 F.3d 1356, 1362 (Fed. Cir. 2010), had rejected a narrow foreseeability test and stated that it is not necessary that "the specific loss in question must have been within the contemplation of the parties at the time of contracting," nor that the "specific mechanism of loss must be foreseeable.").

21. See, e.g., *Elec.-Seattle, Inc. v. Bosko*, 410 P.2d 10, 12 (Wash. 1966); see also discussion in Chapter 4 of this work, accompanying footnotes 106–109.

in these circumstances may depend on a variety of circumstances, including the existence of legal requirements to use listed subcontractors and/or the presence of a stipulation that acceptance of a lower tier contractor's bid is conditional upon negotiation of a contract acceptable to the prime contractor.²²

It should also be kept in mind that oral contracts may be enforceable in some circumstances. Contracts for the supply of goods, however, will generally be subject to the statute of frauds of the Uniform Commercial Code.²³ And contracts for services are usually subject to corresponding restrictions under applicable state laws.²⁴

Some purchasers of construction goods and services attempt to limit their exposure to reliance damages through contract provisions. One typical clause directs that contractors should not incur certain kinds of costs without first receiving a written notice to proceed.²⁵ Unless such provisions are carefully written, they may end up conflicting with other clauses requiring a contractor to achieve completion within a specified time.²⁶ An owner who fails to timely provide an essential notice to proceed should expect that this withholding may require the contractor to request an extension in the time allowed for performance.²⁷ Correspondingly, contractors and suppliers should provide notice as to when they need site access and notices to proceed in order to maintain the desired project schedule.²⁸

In connection with change orders, some owners or general contractors seek to limit their exposure to reliance damages by placing a monetary cap on the

22. *See, e.g.*, *Trianco, LLC v. Int'l Bus. Machines Corp.*, 271 F. App'x 198, 201 (3d Cir. 2008) (agreement to award plaintiff subcontractor contract contingent on future negotiations was not a binding agreement that required prime contractor to award subcontract); *S. California Acoustics Co. v. C. V. Holder, Inc.*, 456 P.2d 975, 980–81 (Cal. 1969) (noting that under Subletting and Subcontracting Fair Practices Act, a prime contractor is bound to use listed subcontractors on public works projects).

23. *See* U.C.C. § 2-201 (2004).

24. *See generally* authorities cited at West's  95 CONTRACTS, k30–46.

25. *See, e.g.*, *Procurement Activities of the Corps of Engineers, Notice to Proceed*, 33 C.F.R. § 210.3 (2012); PHILIP L. BRUNER & PATRICK J. O'CONNOR, JR., 5 BRUNER AND O'CONNOR ON CONSTRUCTION LAW § 15.13 (2011).

26. AIA Document A101-2007, Standard Form of Agreement Between Owner and Contractor where the basis of payment is a Stipulated Sum §§ 3.1–3.3 (carefully wording these clauses by defining the commencement day in the notice to proceed and requiring Substantial Completion by reference to the number of days after commencement).

27. *See* *Abbett Elec. Corp. v. United States*, 162 F. Supp. 772 (Ct. Cl. 1958); BRUNER & O'CONNOR, *supra* note 25, §§ 15.13, 15.52.

28. BRUNER & O'CONNOR, *supra* note 25, §§ 15.8, 15.10 (contractors should seek owner approval of the critical path and may need to update the critical path periodically); *id.* at 15:27 (2011) (noting that a party had a duty to avoid or mitigate damages where possible).

costs being incurred pursuant to the change order.²⁹ The problem with such clauses is that many kinds of construction work do not facilitate instantaneous cost tracking.³⁰ Suppliers and subcontractors may be working at multiple locations, and there is a lag time between incurring costs and submitting them for review by the general contractor and owner.³¹ When changes are directed with a “not to exceed” limit, the affected contractors should make reasonable efforts to keep costs within the specified sum. Where reasonably incurred costs nonetheless run over due to the inherent lag time of cost reporting, however, the parties incurring such costs have a strong argument for equitable compensation.³² It may also be possible to avoid a “not to exceed” limit on reliance damages when a claimant can produce evidence that the owner or its representatives had actual or constructive knowledge that excess costs were being incurred and made no objection (especially when the owner is pressing a contractor to expedite the directed work).³³

V. EXPECTATION DAMAGES

When a construction or supply contract is formed and then breached, American common law generally provides that the nonbreaching party is entitled to recover the compensation that it reasonably could have expected if the contract had been performed. This principle of expectation damages is also said to give nonbreaching parties the benefit of their bargain.³⁴

29. Appeal of Samuel S. Barnett Co., Inc., GSBCA No. 4855, 80-1 B.C.A. (CCH) ¶ 14355 (Mar. 31, 1980) (upholding a not-to-exceed limitation on a change order); Appeal of Knutson Const. Co., GSBCA No. 2760, 69-2 B.C.A. (CCH) ¶ 7921 (Oct. 6, 1969) (same); RALPH C. NASH & STEVEN W. FELDMAN, GOVERNMENT CONTRACT CHANGES § 7.14 (3d ed. 2007); see, e.g., 48 C.F.R. § 243.204-70-2 (2012). *But see* Appeal of Decker & Co., GmbH, ASBCA No. 33285, 88-3 B.C.A. (CCH) ¶ 20925 (May 25, 1988) (finding that unilateral not-to-exceed limitation was not binding).

30. See BARRY B. BRAMBLE & MICHAEL T. CALLAHAN, CONSTRUCTION DELAY CLAIMS §§ 8.01, 8.03 (4th ed. 2011).

31. See *id.* § 8.03[E].

32. Cf. NASH & FELDMAN, *supra* note 29, § 7.14 (noting that where a unilateral change order is issued with a “not to exceed” price, but also requests a detailed cost proposal, the contractor is not bound by the stated price because the terms demonstrate a willingness to allow additional equitable adjustment).

33. Cf. *id.* (noting that any ambiguity or confusion as to the terms of the “not to exceed price” may render it unenforceable); CIBINIC ET AL., ADMINISTRATION OF GOVERNMENT CONTRACTS 477 (4th ed. 2006) (noting that the boards generally do not require formal notice of a change when they have actual knowledge of the facts constituting the constructive change).

34. Bluebonnet Sav. Bank, F.S.B. v. United States, 266 F.3d 1348, 1355 (Fed. Cir. 2001); see California Fed. Bank v. United States, 395 F.3d 1263, 1267 (Fed. Cir. 2005).

Black's Law Dictionary defines "expectation damages" as "[c]ompensation awarded for the loss of what a person reasonably anticipated from a transaction that was not completed."³⁵ According to the Restatement, "Contract damages are ordinarily based on the injured party's expectation interest and are intended to give him the benefit of his bargain by awarding him a sum of money that will, to the extent possible, put him in as good a position as he would have been in had the contract been performed."³⁶

The Restatement adds that an injured party's "expectation interest"³⁷ may be measured by:

1. The loss in the value to him of the other party's performance caused by its failure or deficiency, plus
2. Any other loss, including incidental or consequential loss, caused by the breach, less
3. Any cost or other loss that he has avoided by not having to perform.³⁸

From the standpoint of a service provider in the construction industry (e.g., contractor, designer, or supplier), the measure of lost value is generally based on the unpaid balance of a mutually agreed contract price. From the standpoint of a project owner, the measure of lost value is generally based on the reasonable cost of securing an alternative service provider to complete the work that was started by a breaching contractor.

It should be noted that "incidental or consequential" damages are generally a recoverable element of damages unless they are excluded by contract. In contracts for supply of goods, the Uniform Commercial Code specifically allows incidental and consequential damages to either an injured seller³⁹ or to an injured buyer.⁴⁰

Incidental damages are loosely defined as "losses reasonably associated with or related to actual damages."⁴¹ When a construction owner breaches a contract to purchase goods for a project, it will generally be liable for the supplier's "commercially reasonable charges, expenses or commissions incurred in stopping delivery, in the transportation, care, and custody of goods after the buyer's breach, in connection with return or resale of the goods or otherwise

35. BLACK'S LAW DICTIONARY "expectation damages."

36. RESTATEMENT (SECOND) OF CONTRACTS § 347 cmt. a (1981).

37. *Id.* § 344 cmt. a (defining "expectation interest" as a party's "interest in having the benefit of his bargain by being put in as good a position as he would have been in had the contract been performed"); see *Glendale Fed. Bank v. United States*, 239 F.3d 1374, 1380 (Fed. Cir. 2001).

38. RESTATEMENT (SECOND) OF CONTRACTS § 347 (1981).

39. U.C.C. § 2-710 (2004).

40. *Id.* § 2-715.

41. BLACK'S LAW DICTIONARY "incidental damages."

resulting from the breach.”⁴² When a supplier of construction goods breaches its contract, the buyer will generally be entitled to recover all “expenses reasonably incurred in inspection, receipt, transportation and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with effecting cover and any other reasonable expense incident to the delay or other breach.”⁴³ In a construction service agreement, unless incidental damages are effectively disclaimed, a breach by one party should allow the nonbreaching party to recover analogous damages. For example, when a builder defaults, the owner’s incidental damages might include reasonable costs of inspecting partially completed work, removing defective work, storing materials as required, and retaining a contractor to complete the work as specified.

There does not appear to be a consensus on the definition of consequential damages.⁴⁴ In general, they are “losses that do not flow directly and immediately from an injurious act, but that result indirectly from the act.”⁴⁵ Their status is affected by the requirement that recoverable damages must be reasonably foreseeable.⁴⁶ In a construction context, an owner’s consequential damages arising from delay or other breach by a defaulting contractor are generally thought to include:

- Extended contract inspection and administration
- Lost revenue arising from delayed availability of completed facility
- Loss of use of new facility (e.g., costs of continuing to rent or own a pre-existing facility that must be retained because the new replacement is not ready on time)⁴⁷
- Diminished value of completed facility due to late completion.

42. U.C.C. § 2-710(1) (2004).

43. *Id.* § 2-715(1).

44. Arthur Corbin apparently felt that the expression “consequential damages” was so vague that its use “should be abandoned.” CORBIN § 1011, at 75.

45. BLACK’S LAW DICTIONARY “consequential damages.”

46. *See* Richard A. Lord, *Damages for Breach of Contract: Consequential Damages, Foreseeability*, 24 WILLISTON ON CONTRACTS § 64:13 (4th ed., updated 2011). For a thoughtful discussion of this subject, *see* Howard Goldberg, *Hadley v. Baxendale, Consequential Damages & Modern Contract Law*, AIA CONTRACT DOCUMENTS: GENERATION NEXT at 297 (ABA 1997).

47. *But see* CHARLES M. SINK & MARK D. PETERSEN, THE A201 DESKBOOK 76 (1998) (suggesting that an owner’s loss of use of a project building should be treated as a direct damage rather than as a consequential damage); *see also* CHARLES M. SINK ET AL., THE 2007 A201 DESKBOOK 108–09 (2008) (noting that the 2007 edition A201 Mutual Waiver of Consequential Damages provision (§ 15.1.6) has been modified to allow for negotiation of liquidated damages that includes both direct and indirect losses, whereas the 1997 edition limited negotiation of liquidated damages to liquidated “direct” damages).

These elements are often considered by owners in calculating and specifying liquidated delay damages in their contracts.

Examples of contractors' consequential damages arising from owner breaches can include:

- Lost profits on other jobs that might otherwise have been performed
- Loss of project financing
- Loss of project bonding.

Examples of supplier consequential damages can include:

- Lost profits that could have been earned on purchase orders for other customers, using the shop time allocated to the job where the default occurred
- Costs of expanding staff or production facility to accommodate the contract that was breached.

Some courts and contract forms (including AIA Document A201) treat home office personnel expense as a form of consequential damages.⁴⁸ This approach makes sense only if applied to home office overhead costs not reasonably attributable to a specific project. When home office personnel devote time to compensable issues on a specific project, however, it seems unreasonable to characterize the associated costs as “consequential” damages.⁴⁹

As exemplified in the 1997 and 2007 editions of the American Institute of Architects A201 General Conditions,⁵⁰ there has been a recent trend toward mutual contract waivers of consequential damages. This waiver appears to reflect a widespread perception that broad exposure to consequential damages

48. See AIA Document A201-2007, General Conditions of the Contract for Construction § 15.1.6. (including in the definition of consequential damages “damages incurred by the Contractor for principal office expenses including the compensation of personnel stationed there”); see, e.g., *Wright Schuchart, Inc. v. Cooper Indus., Inc.*, 40 F.3d 1247 (9th Cir. 1994); *Int’l Fid. Ins. Co. v. County of Rockland*, 98 F. Supp. 2d 400, 416 n.8 (S.D.N.Y. 2000); *Stroh Corp.*, GSBICA No. 11029, 96-1 B.C.A. (CCH) ¶ 28265 (Mar. 29, 1996).

49. See, e.g., *Appeal of Centex Bateson Constr. Co.*, VABCA No. 5162, 99-1 B.C.A. (CCH) ¶ 30153 (Dec. 3, 1998) (“the costs of drawing review, coordination of work, and change proposal preparation . . . are ordinarily considered to be indirect costs of a change for which a contractor receives compensation through the overhead and profit rates applied to the direct costs . . . However, if [a contractor is] required to incur extraordinary engineering, coordination, or other extraordinary office costs, such costs could be considered as a separate constructive change for which it would be compensated directly.”).

50. AIA Document A201-2007, General Conditions of the Contract for Construction § 15.1.6 calls for the owner and contractor to waive claims against each other for all consequential damages, provided that the owner may still collect any specified “liquidated direct damages.” Section 4.3.10 in the A201-1997 document contained similar language.

can easily be out of proportion to the limited fees being paid for design, construction, and supply services. Suppliers and service contractors who cannot afford to bear such risks (and who cannot obtain or afford insurance against them) may be compelled to insist on being insulated from them as a matter of contract. The enforcement of such waivers will be addressed in Chapter 10.

After determining the lost value resulting from breach and any incidental or consequential damages arising from the same, a calculation of expectation damages must generally offer credit for costs that the nonbreaching party has avoided on account of the breach.⁵¹ In a construction or supply context, this obviously involves calculating the costs that the nonbreaching party would reasonably have incurred to complete its work but for the breach of contract. If the breaching party can prove that the nonbreaching party would have lost money in completing the job as bid, the damage award should be reduced by a credit for that amount.⁵²

At the same time, a nonbreaching contractor that avoids performing work may in some circumstances argue cogently for damages in excess of its lost profit.⁵³ Especially when work is scarce, a contract may offer value both to generate profit and to provide ongoing employment for crews who would otherwise be laid off. This sort of economic harm would probably be characterized as a kind of consequential damage.⁵⁴

The Restatement of Contracts also notes several exceptions to the right to recover expectation damages, suggesting that the nonbreaching party should not recover damages that (a) it reasonably could have avoided without undue risk through mitigation,⁵⁵ (b) the breaching party did not have reason to foresee,⁵⁶ or (c) could not be established with reasonable certainty.⁵⁷

The requirement for damages to be reasonably foreseeable has previously been discussed in this chapter. The nonbreaching party's duty to mitigate will be addressed in Chapter 11, and the issue of proof will be addressed in Chapter 12.

51. See *Indiana Michigan Power Co. v. United States*, 422 F.3d 1369, 1374–75 (Fed. Cir. 2005); *Pac. Gas & Elec. Co. v. United States*, 92 Fed. Cl. 175, 179–80 (2010).

52. See *Bluebonnet Sav. Bank, F.S.B. v. United States* 339 F.3d 1341, 1344–45 (Fed. Cir. 2003); *Kansas Gas & Elec. Co. v. United States*, 95 Fed. Cl. 257, 273–75 (2010).

53. ROBERT F. CUSHMAN ET AL., *PROVING AND PRICING CONSTRUCTION CLAIMS* § 7.28 at 23 (3d ed. 2001 & Supp. 2008) (noting that a contractor may seek to recover damages relating to loss of future profits and impairment of goodwill). *But see* *Traylor v. Henkels & McCoy, Inc.*, 585 P.2d 970, 972–73 (Idaho 1978) (denying recovery for injury to business and loss of future profit on grounds of foreseeability).

54. *Cf.* CUSHMAN ET AL., *supra* note 53, § 1.06[G] (noting loss of goodwill and future loss profits are a form of indirect costs arising from the breach).

55. RESTATEMENT (SECOND) OF CONTRACTS § 350(1) (1981).

56. *Id.* § 351(1).

57. *Id.* § 352.

The Restatement offers a number of illustrations in the context of construction contracts. For example, an owner's claim for delay in completion of a new hotel must be offset by the avoided cost of operating the hotel during the delay period.⁵⁸ When an owner repudiates a contract for construction of a new house, the contractor's claim for the balance of its price is offset by the reasonable cost of completing the house.⁵⁹ When an owner's default leaves a contractor with leftover materials that can be readily used on other projects, the contractor's claim for damages must give credit for the saved cost of those materials.⁶⁰ The fact that a contractor performs similar work for another owner after being improperly defaulted by the first owner does not bar the contractor from recovering lost profits on the first job, unless the defaulting owner can prove that the contractor's business was incapable of performing both jobs.⁶¹

VI. EQUITABLE THEORIES

Equitable relief is generally a matter for a court, not for a jury.⁶² When a court concludes that an award of money damages is an insufficient remedy for a breach of contract, several alternative remedies may be available under principles of equity.⁶³

A. RESCISSION

One of the traditional equitable remedies is rescission. It is generally intended to describe a remedy by which parties are returned as closely as possible to their pre-contract positions.⁶⁴ When a contractor is put back into its pre-contract position, it is not entitled to recover lost profit, so the rescission remedy is

58. RESTATEMENT (SECOND) OF CONTRACTS § 347 illus. 5 (1981).


59. *Id.*, illus. 6.

60. *Id.*, illus. 7.

61. *Id.*, illus. 16.

62. See authorities cited at West's  150 EQUITY, k369-92.

63. See *id.*, k43-49. The United States Supreme Court has repeatedly held that remedies in equity will not be imposed if there is an adequate remedy at law. See, e.g., *Boise Artesian Hot & Cold Water Co. v. Boise City*, 213 U.S. 276, 281 (1909) ("It is a guiding rule in equity that in such a case it will not interpose where there is a plain, adequate and complete remedy at law. This rule at an early date was crystallized into statute form by the sixteenth section of the Judiciary Act [Revised Statutes, § 723], which, if it has no other effect, emphasizes the rule and presses it upon the attention of courts"); *New York & Co. v. Memphis Water Co.*, 107 U.S. 205, 214 (1883). It is so well settled and has so often been acted upon that no authority need be cited in its support, though it must not be forgotten that the legal remedy must be as complete, practicable, and efficient as that which equity could afford. *Walla Walla v. Walla Walla Water Co.*, 172 U.S. 1, 11 (1898).

64. See authorities cited at West's  95 CONTRACTS, k249-74.


most attractive to contractors working on a project that is unlikely to generate a substantial profit.⁶⁵



Although the traditional definition of rescission seems to have been limited to situations where parties mutually agree to discharge and terminate their duties under an existing contract,⁶⁶ the term is also sometimes applied to the unilateral right of a nonbreaching party to be discharged from further performance by the other party's material breach of contract.⁶⁷ Courts also hold that a party may unilaterally "rescind" an agreement based on failure of consideration or impossibility of performance.⁶⁸

Arthur Corbin argues cogently that the term "rescission" should not be used to describe the unilateral right of a nonbreaching party.⁶⁹ To clarify the issue, Corbin distinguishes contract "rescission" from "termination" or "cancellation," with "the latter two terms being applicable only to the rendition of further performance as provided in the contract, leaving intact all claims for performance rendered or breaches committed in the past." But he acknowledges that usage of this definitional distinction "is not so uniform as to be decisive in interpretation."⁷⁰

65. See discussion of when rescission is favorable to contractors in CUSHMAN ET AL., *supra* note 53, § 7.29, at 235.

66. See CORBIN § 1236, at 26.

67. See, e.g., BLACK'S LAW DICTIONARY "rescission." ("A party's unilateral unmaking of a contract for a legally sufficient reason, such as the other party's material breach"); see also authorities cited at West's  95 CONTRACTS, k261. Federal government contractors may also obtain rescission for their own bidding errors, otherwise inexcusable, when regulations require government agencies to inspect bids for mistakes. *Giesler v. United States*, 232 F.3d 864, 869, 869–72 (Fed. Cir. 2000) (citing *United States v. Hamilton*, 711 F.2d 1038, 1046 (Fed. Cir. 1983)).

68. For lack of consideration, see authorities cited at West's  95 CONTRACTS, k260. For impossibility of performance, see authorities cited at West's  95 CONTRACTS, k261(5).

69. See CORBIN § 1237, at 36 (citations omitted):

Without doubt a considerable amount of injustice has been done by reason of variation and confusion in the use of the term "rescission." When one party repudiates the contract or otherwise commits a very material breach, this fact may in itself discharge the other party from further duty under the contract. This is not a "rescission" or even an offer of a rescission; yet is it often said that such a breach privileges the other party to "rescind" the contract. This usage has caused serious difficulty; it should not be hopeless to try to eliminate it.

See also *id.* § 1105, at 18–23.

70. *Id.* § 1236, at 30–31.

Under the Uniform Commercial Code, this right to undo the original contract is described in terms of a buyer's rights to reject⁷¹ or revoke acceptance⁷² of non-conforming goods. In the laws governing contracts for design or construction services, however, even one party's material breach generally does give another party the right to insist on returning to the *status quo ante*. In service contracts, there is no "perfect tender rule," and providers of construction services are generally held merely to the standard of "substantial performance"⁷³ rather than to the more unattainable standard of "free from defects."

When one contract party repudiates its contract or has committed a vital breach in some other way, it is generally held that the injured party acquires "a legal privilege of performing no further on his own part and a legal right to be compensated in some form for the wrong done him."⁷⁴ Whether or not this right is defined as a right of "rescission," it is an important right in an industry where service providers are typically required to invest large sums of money in reliance on contract assurances of receiving periodic (typically monthly) progress payments.

In the construction industry, project owners frequently seek to narrow the foregoing principle by including broadly worded clauses to the effect that contractors are required to continue performing work at their own expense even if there is a pending claim in dispute. However, well-established principles of equity would appear to place some outer limits on the enforcement of such clauses. For example, a court may find it unreasonable to require that a designer, contractor, or supplier should continue performing unpaid work in the following cases:

- The owner's delay or withholding of earned payments is sufficiently large as to impair the financial ability of the general contractor or its subcontractors to continue work.
- Ongoing work would require contractors to perform changes in scope or schedule entailing a substantially larger cash flow investment than reasonably contemplated when they bid on the job.
- The owner is attempting to impose a change outside the scope of the original contract (sometimes termed a "cardinal change").
- The contractor can adduce evidence that the owner's ability to pay for further work is substantially in doubt.

71. U.C.C. § 2-602 (2004).

72. *Id.* § 2-608.

73. See authorities cited at West's  95 CONTRACTS, k293-95.

74. CORBIN § 1105, at 20.

Many contract clauses compromise on this point by linking the contractor's duty to continue work (despite disputes) to the owner's duty to continue making timely payments.⁷⁵

Once a contract is validly formed, and especially when it has been partly fulfilled, most courts will seek to effectuate what they construe as the parties' original mutual intent, and they will seldom grant the unilateral request of one party to restore all parties to their pre-contract positions.

B. REFORMATION

One equitable remedy that equitably modifies a contract while leaving it in effect is reformation. This remedy can be defined as revising a written agreement "to reflect the actual intent of the parties, usu[ally] to correct fraud or mutual mistake."⁷⁶ The most common application of reformation is the latter, which can be summarized as follows:

Where a writing that evidences or embodies an agreement in whole or in part fails to express the agreement because of a mistake of both parties as to the contents or effect of the writing, the court may at the request of a party reform the writing to express the agreement, except to the extent that rights of third parties such as good faith purchasers for value will be unfairly affected.⁷⁷

An intended third-party beneficiary or a party's successor in interest may also have standing to request reformation of a contract based on mutual mistake.⁷⁸


Examples of circumstances that might justify a contract reformation include:


- Correcting a technical error in execution of a document⁷⁹
- Correcting an error in the legal description of the mutually contemplated project site⁸⁰
- Revising a plan sheet or specification to incorporate the mutually agreed substance of a negotiated change order


75. *See, e.g.*, AIA Document A201-2007, General Conditions of the Contract for Construction § 15.1.3 ("Pending final resolution of a Claim except as otherwise agreed in writing or as provided in Section 9.7 and Article 14, the Contractor shall proceed diligently with performance of the Contract and the Owner shall continue to make payments in accordance with the Contract Documents"). Section 9.7 provides a right to stop work in the face of delayed payment, and Section 14.1.3 ultimately gives the unpaid contractor a right to terminate the agreement on this basis.

76. BLACK'S LAW DICTIONARY "reformation."

77. RESTATEMENT (SECOND) OF CONTRACTS § 155 (1981).

78. RESTATEMENT (SECOND) OF CONTRACTS § 155 cmt. e (1981); *see also* authorities cited at West's  328 REFORMATION OF INSTRUMENTS, k26.

79. *See* authorities cited at West's  328 REFORMATION OF INSTRUMENTS, k12.

80. *See* authorities cited at West's  328 REFORMATION OF INSTRUMENTS, k13.

- Clarifying any portion of the contract documents when the parties mutually intended something different than what is stated.

It must be noted, however, that errors in business judgment and negligent failure to read specifications do not qualify as mutual mistakes justifying reformation.⁸¹ Erroneous bids based on mistakes in judgment generally do not entitle contractors to contract reformation.⁸²

Correction of a mutual mistake may in some cases justify an equitable adjustment to the contract in question. If, for example, an owner and contractor both assume erroneously that a specified design detail will meet building codes, the correction of that assumption may necessitate a change to the contract. If the governing code authority in fact requires a different method of installation, and if that change equitably justifies an increase in the cost or time of contract performance, the contractor should receive an appropriate change order. Thus, the right to contract reformation may be separate from the issue of whether the corrective change is compensable.

Many current construction contract forms provide that if one clause is legally invalidated, the others shall remain in effect unless enforcing those remaining terms on their own would be substantially inequitable. The term “reformation” may also be applied to the equitable remedy by which a contract is modified to remove a specific provision that is for some reason unenforceable.

C. RESTITUTION

In cases where the more traditional remedies of reliance or expectation damages are insufficient, courts sometimes allow the remedy of restitution. The Restatement offers the following as part of its introduction to this topic:

Restitution is a common form of relief in contract cases. It has as its objective not the enforcement of contracts through the protection of a party’s expectation or reliance interests but the prevention of unjust enrichment through the protection of his restitution interest. See § 344. A party who has received a benefit at the expense of the other party to the

81. *Giesler, supra* note 67, 232 F.3d at 870–71.

82. *Hamilton, supra* note 67, 711 F.2d at 1048. In very limited contexts, unilateral error may constitute grounds for reformation where necessary to prevent injustice. *Info. Int’l Assoc., Inc. v. United States*, 74 Fed. Cl. 192, 193 (2006); *Giesler, supra* note 67, 232 F.3d at 869, *quoting* *Liebherr Crane Corp. v. United States*, 810 F.2d 1153, 1157 (Fed. Cir. 1987) (“a contractor may obtain reformation or rescission of the contract only if the contractor establishes that its bid error resulted from a ‘clear cut clerical or arithmetical error, or a misreading of the specifications.’ If the contractor’s error does not constitute one of these kinds of mistakes, then the contractor is not eligible for reformation of the contract.”).

agreement is required to account for it, either by returning it in kind or by paying a sum of money.⁸³

Because restitution is based on compensation for a benefit conferred, it is available only to a claimant who either has started performing a contract or has incurred costs in reliance thereon.⁸⁴ On the other hand, restitution will generally not be available if the contract is fully performed, because at that point the plaintiff usually has an adequate remedy at law (e.g., a claim for payment of the stipulated contract price).⁸⁵ Like rescission, restitution is a backward-looking remedy that can allow an injured contractor to avoid a losing contract situation.⁸⁶

A restitutionary recovery is typically measured in either of two ways:⁸⁷

1. The reasonable value to the defendant of what it received,⁸⁸ in terms of what it would have cost to obtain the same benefit from another person in the plaintiff's position; or
2. The extent to which the value of the defendant's property has been increased or other interests of the defendant have been advanced.

Courts may be more generous in granting restitution where a benefit has been conferred by way of part performance, as distinguished from reliance in some

83. RESTATEMENT (SECOND) OF CONTRACTS, ch. 16, Topic 4, Introductory Note (1981). Section 344 defines "restitution interest" as a party's "interest in having restored to him any benefit that he has conferred on the other party."

84. *Id.* at §§ 370, 373; *see also* Mobil Oil Exploration & Prod. Southeast, Inc. v. United States, 530 U.S. 604, 608 (2000); Amber Res. Co. v. United States, 73 Fed. Cl. 738, 743 (2006), *aff'd*, 538 F.3d 1358 (Fed. Cir. 2008).

85. *See* CORBIN §§ 1110–11, at 34 *et seq.*

86. JUSTIN SWEET, SWEET ON CONSTRUCTION LAW § 11.7, at 409 (1997) ("Most courts allow the contractor in a losing contract to use restitution and ignore any possible losses, as long as, paradoxically, he has *not completed* performance. He can establish the amount of money that his work has enhanced the owner."); *see also* Landmark, *supra* note 14, 256 F.3d at 1372 ("The idea behind restitution is to restore—that is, to restore the non-breaching party to the position he would have been in had there never been a contract to breach."); *see also* Hansen Bancorp, Inc. v. United States, 367 F.3d 1297, 1309 (Fed. Cir. 2004).

87. RESTATEMENT (SECOND) OF CONTRACTS § 371 (1981); *see also* Landmark, *supra* note 14, 256 F.3d at 1372.

88. CORBIN § 1109, at 31–33 ("One who has rendered service or supplied work, labor, and materials under a contract with another, but who has been wrongfully discharged or otherwise prevented from so far fully performing as to earn the agreed compensation, may regard the contract as terminated and get judgment for the reasonable value of all that the defendant has received in performance of the contract. This rule is applicable to contracts of personal service and to all kinds of construction contracts. The defendant's breach may have been a repudiation, a discharge, a prevention of performance by the plaintiff, or a failure to perform the agreed exchange due from the defendant").

other way, and uncertainties as to the value of the benefit conferred are likely to be resolved against the claimant if it has also breached the agreement.⁸⁹

In the context of damages for breach of a construction contract, an agreed contract price (or, arguably, a mutually agreed schedule of values within the contract price) may operate as a limit on recoverable damages, because justice may not permit an injured plaintiff to recover more than it specifically agreed to accept in full compensation for the work that it was not permitted to finish.⁹⁰ Restitution should, however, be available where unresolved changes in the scope, sequence, or duration of work are of sufficient magnitude to render the original contract price an inadequate basis for calculating full equitable compensation.

For a plaintiff to receive restitution based on a breach of contract, the breach must be “vital”—i.e., affecting a fundamental term of the agreement.⁹¹ In the construction context, a material failure to make progress payments when due would generally be an example of such a breach. There are, however, many cases in which “a plaintiff is entitled to restitution even though no contract whatever has been made, or even though the defendant has been discharged from duty under an existing contract and has been guilty of no breach whatever.”⁹² Thus, restitution can be available both as a remedy for breach and as a quasi-contractual remedy.⁹³ For example, a party who confers a benefit on another party under a contract that is later voided (e.g., due to illegality, impracticability, lack of capacity, mistake, or duress) may be able to claim restitution if there is no sufficient alternative remedy at law.⁹⁴

D. IMPLIED CONTRACTS AND *QUANTUM MERUIT*


In proper circumstances, equity provides monetary relief where the injured party has no adequate remedy at law and where (a) an existing contract has been fundamentally breached, (b) a contract is voided as a matter of law, or (c) the existence of a contract must be implied to prevent unjust enrichment. The previously described remedy of restitution is sometimes available in each of these three circumstances.

89. RESTATEMENT (SECOND) OF CONTRACTS § 371 cmt. a (1981).

90. *Id.* § 373, cmt. b.

91. CORBIN § 1104.

92. *Id.*


93. *See, e.g.,* *Bill v. Gattavara*, 209 P.2d 457, 460 (Wash. 1949) (“‘restitution’ and ‘unjust enrichment’ are the modern designation for the older doctrine of ‘quasi contracts’”); *see generally* authorities cited at West’s  205H IMPLIED AND CONSTRUCTIVE CONTRACTS, k2-k4.

94. *See, e.g.,* RESTATEMENT (SECOND) OF CONTRACTS § 375 (1981) (contract voided due to statute of frauds); *id.* § 376 (contract voidable for other reasons); *id.* § 377 (contract discharged by impracticability, frustration, or nonoccurrence of essential condition).

So-called constructive contracts do not depend upon mutual assent, but are generally implied by law when it would be unjust for a recipient to retain a benefit without paying for it.⁹⁵ The restitutionary mirror image of unjust enrichment is *quantum meruit* (“the amount he deserves”), a theory grounded on the notion that one who has provided goods or services should be compensated for doing so.⁹⁶

In an unjust enrichment case, damages are set by the value to the defendant of the benefit received; in a *quantum meruit* case, however, damages are measured by the reasonable value of work and materials provided by the plaintiff.⁹⁷ The theory of *quantum meruit* exists separately from unjust enrichment in order to address those situations where it would be fundamentally unfair to deny recovery to a plaintiff for his efforts simply because they conferred no value on the defendant.⁹⁸ As one author explained, in *quantum meruit* the law supplies the missing contract price from the implied contract by asking what one would have to pay in the open market for the same work. In contrast, unjust enrichment is not premised on there having been “assent” between the parties.⁹⁹

Courts may find that the parties’ conduct has effectively created a contract even when no formal agreement exists. This constitutes a contract “implied in fact” and is distinguished from a contract “implied in law,” which exists without regard to the parties’ intentions or conduct.¹⁰⁰ Over time, the distinctions

95. See authorities cited at West’s  205H IMPLIED AND CONSTRUCTIVE CONTRACTS, k1–4; *Hercules Inc. v. United States*, 516 U.S. 417, 424 (1996) (“an agreement implied in law is a ‘fiction of law’ where ‘a promise is imputed to perform a legal duty’”) (*quoting* *Baltimore & Ohio R. v. United States*, 261 U.S. 592, 597 (1923)).

96. See *Barrett Refining Corp. v. United States*, 242 F.3d 1055, 1061 (Fed. Cir. 2001) (*quantum meruit* provides an equitable remedy allowing recovery of “the value of goods or services provided[, and] [a]ccordingly, only the provider of the goods or services has such a claim”); *Allied Home Mortg. Capital Corp. v. United States*, 95 Fed. Cl. 769, 785–86 (2010) (“[w]here a benefit has been conferred by the contractor on the government in the form of goods or services, which it accepted, a contractor may recover at least on a *quantum valebant* or *quantum meruit* basis for the value of the conforming goods or services received by the government prior to the rescission of the contract for invalidity. The contractor is not compensated under the contract but rather under an implied-in-fact contract”).

97. See 66 AM. JUR. 2D *Restitution and Implied Contracts* § 37 (2010).

98. See, e.g., *United States v. Amdahl Corp.*, 786 F.2d 387, 393–94 (Fed. Cir. 1986) (citing example of contract voided for illegality, with substantial start-up costs incurred by contractor, but no actual benefit accruing to government, as a situation where unjust enrichment recovery would not adequately compensate contractor but *quantum meruit* would).

99. Hugh McConnell, *Distinguishing Quantum Meruit and Unjust Enrichment in the Construction Setting*, 71 FLA. B. J. 88 (March 1997).

100. BRUNER & O’CONNOR, *supra* note 25, § 2:5.


between these concepts have been eroded by lack of precision in judicial opinions, by legal commentators, and by modern legal trends.¹⁰¹

In cases where equitable payments are collected from a project owner who repudiates or otherwise fundamentally breaches a contract to pay for construction services or materials, courts are likely to apply the label of equitable restitution. Where equitable relief is granted because a contractor's costs, sequences, method, or schedule are pervasively changed, however, courts often prefer to characterize the basis for compensation as *quantum meruit*.¹⁰² Courts may likewise apply *quantum meruit* as a theory of recovery in proper circumstances where the contract has been voided (illegality, fraud, duress).¹⁰³

Although we noted above that restitution is traditionally not available to a contractor that has completed its performance of a contract with an agreed price, *quantum meruit* recovery can be afforded to such a contractor. Such relief is allowed, however, only where the project was sufficiently changed, delayed, or otherwise disrupted by causes attributable to the owner so that recovery based on the originally agreed contract price would be inequitable.

Some common fact situations where *quantum meruit* recovery may be allowed are where (1) a subcontractor provides services beyond the scope of its written subcontract at the owner's request and under the owner's supervision;¹⁰⁴ (2) an owner receives the benefit of a subcontractor's work but does not pay the general contractor for it;¹⁰⁵ (3) a contractor provides services as if a contract existed, although none is actually executed;¹⁰⁶ (4) during performance of an agreed scope of work, an accident or act of God requires additional work to

101. *Id.* § 19:36.

102. For authorities addressing *quantum meruit* recovery by parties furnishing labor, materials, or other expenses, see authorities cited at West's  IMPLIED CONTRACTS k30-32. The term *quantum valebant* is occasionally used interchangeably with the term *quantum meruit*. The former applies to goods, the latter to services, and there seems to be "functionally no difference" in applying these two principles. *Urban Data Sys., Inc. v. United States*, 699 F.2d 1147, 1154 n.8 (Fed. Cir. 1983).

103. *Amdahl, supra* note 98, 786 F.2d at 393 ("it would violate good conscience to impose upon the contractor *all* economic loss from having entered an illegal contract") (emphasis in original).

104. John W. Wade, *Restitution for Benefits Conferred Without Request*, 19 VAND. L. REV. 1183 (1966).

105. For example, IND. CODE § 32-28-3-9 (West 2011) allows a subcontractor to give written notice to a property owner that the subcontractor is holding the owner responsible for an amount owed by a general contractor or lessee, to the extent that payment is or may become due from the owner to that general contractor or lessee. See Annotation, *Building and Construction Contracts: Right of Subcontractor Who Has Dealt Only With Primary Contractor to Recover Against Property Owner in Quasi Contract*, 62 A.L.R.3D 288 (1975 & Supp. 2000).

106. See, e.g., *Original Grasso Constr. Co. v. Shepherd*, 799 A.2d 1083 (Conn. Ct. App. 2002); *Wingate Land & Dev. LLC v. Robert C. Walker, Inc.*, 558 S.E.2d 13 (Ga. Ct. App. 2001).

prevent further damage;¹⁰⁷ (5) an owner requests extra work without executing a written change order;¹⁰⁸ or (6) while performing the planned scope of work, a contractor encounters unforeseen conditions making performance of the work unexpectedly difficult. Recovery in *quantum meruit* may also be allowed when a court finds that a contractor has experienced a cardinal change¹⁰⁹ or when the contractual change order process has essentially been abandoned by the parties.¹¹⁰

Twenty-two states have adopted some form of the abandonment or cardinal change doctrine;¹¹¹ however, Mississippi has expressly rejected these theories.¹¹² Abandonment claims on public projects have been recognized by eight states and Puerto Rico.¹¹³ In addition, 18 states and Washington, D.C., recognize abandonment claims on private projects, but have not ruled regarding their application on public jobs.¹¹⁴ Oregon law allows *quantum meruit* recovery by a party whose performance has been made substantially more onerous by the breaches of the other party, but does not require proof that the parties intended to abandon the contract.¹¹⁵ Unlike most jurisdictions, California distinguishes between the doctrines of “abandonment” and “cardinal change.” In an abandonment claim, the contractor is entitled to recover its total cost (less payments) for work before and after the abandonment. In a cardinal change claim, the contrac-

107. See, e.g., *Berry v. Barbour*, 279 P.2d 335, 337–39 (Okla. 1954).

108. See, e.g., *Fox v. Mountain W. Elec., Inc.*, 52 P.3d 848, 852–54 (Idaho 2002). The availability of a *quantum meruit* remedy may, however, depend on whether the claimant has signed a contract that strictly requires all changes to be directed in writing. See, e.g., *P&D Consultants, Inc. v. City of Carlsbad*, 119 Cal. Rptr. 3d 253, 259–61 (Cal. Ct. App. 2010), *rev. denied* (Apr. 13, 2011).

109. See, e.g., *J.A. Jones Constr. Co. v. Lehrer McGovern Bovis, Inc.*, 89 P.3d 1009, 1019–20 (Nev. 2004).

110. See, e.g., *C. Norman Peterson Co. v. Container Corp. of America*, 218 Cal. Rptr. 3d 592 (Cal. Ct. App. 1985). *But see* *Amelco Elec. v. City of Thousand Oaks*, 38 P.3d 1120 (Cal. 2002) (limiting abandonment relief on public contracts); *Sehulster Tunnels/Pre-Con v. Traylor Bros., Inc./Obayashi Corp.*, 4 Cal. Rptr. 3d 655 (Cal. Ct. App. 2003) (holding that although a public entity cannot be held liable under an abandonment theory, abandonment theory could be asserted by a subcontractor against a general contractor on a public project).

111. Aaron Silberman, *Beyond Changes: Abandonment and Cardinal Change*, 22:4 THE CONSTR. LAW 5, 10 n.3 (Fall 2002) (list of jurisdictions adopting cardinal change or abandonment doctrines).

112. *Litton Sys., Inc. v. Frigitemp Corp.*, 613 F. Supp. 1377 (S.D. Miss. 1985).

113. Aaron Silberman, *Abandonment and Cardinal Change on State and Local Construction Projects*, 9 THE PROCUREMENT LAW 17 (Spring 2004). The states are Arizona, Arkansas, Illinois, Maine, New York, Oregon, Washington, and Wyoming.

114. *Id.* The states are Alabama, Colorado, Indiana, Kentucky, Louisiana, Maryland, Michigan, Minnesota, Missouri, Nevada, Ohio, South Dakota, Texas, Utah, and Wisconsin.

115. *City of Portland v. Hoffman Constr. Co.*, 596 P.2d 1305 (Or. 1979), *citing* *McDonald v. Supple*, 190 P. 315 (Or. 1920), and *Hayden v. City of Astoria*, 164 P. 729 (Or. 1917).


tor is entitled only to breach of contract damages for the additional work resulting from the changes.¹¹⁶

Some courts may hold that *quantum meruit* recovery is available only to compensate for changes, delays, or other disruptions that are beyond the scope or reasonable contemplation of the contracting parties.¹¹⁷ This type of analysis is not particularly helpful, however, because there is usually no clear basis on which a trier of fact can determine how many owner changes, differing site conditions, delays, and other impacts should have been contemplated (especially in a competitive award situation where bidders typically cannot afford to inflate their prices with allowances for speculative contingencies).

Most construction contracts and some supply contracts contain clauses that specifically provide for equitable adjustments in price and schedule when a project is impacted by owner changes, differing site conditions, and other specified events. To the extent that cost impacts of such events can reasonably be segregated and quantified, a claimant contractor will often have an adequate remedy of damages at law—e.g., applying agreed unit prices, agreed rates for extended overhead costs, or traditional principles of reliance damages.¹¹⁸ Where changes or disruptions to the scope, sequence, or duration of a project are sufficiently pervasive, however, a contractor's only adequate remedy may lie in replacing the original contract pricing with payment on an equitable theory of *quantum meruit*.

Some courts may deny remedies in *quantum meruit* based on the claimant's failure to submit contractually required notices of claim.¹¹⁹ A number of jurisdictions have held that a contractor's suit against a public body on a *quantum meruit*

116. Aaron Silberman, *supra* note 113, at 17.

117. See authorities cited at West's  205H IMPLIED AND CONSTRUCTIVE CONTRACTS, k64.

118. In discussing labor productivity, the Defense Contract Audit Agency's CONTRACT AUDIT MANUAL (February 2012) states at § 9-504.6:

Causes and effects can be separately measured, provided the change is sufficiently pronounced and not obscured by other factors. A change in tools or the introduction of a highly improved production process might be related to a specific reduction in the required labor hours; or a change in design might be related to an increase in labor hours. Factors which affect productivity operate interdependently, and it is difficult to evaluate separately the effect of any one factor.

119. See, e.g., *County Comm'rs v. J. Roland Dashiell & Sons*, 747 A.2d 600 (Md. 2000); *Hensel-Phelps Constr. Co. v. King Co.*, 787 P.2d 58 (Wash. Ct. App. 1990). *But see* Adam B. Brotman, Note & Comment., *The Ties of Natural Justice: Restoring Quantum Meruit for Contractors in Washington*, 69 WASH. L. REV. 431 (1994). For a broader analysis of claim notice provisions, see Douglas Oles, *Lack of Claim Notice as a Defense to Construction Claims*, 52:1 THE CONSTR. LAW. 6 (Winter 2012).

theory is barred on sovereign immunity grounds.¹²⁰ The rationale is that the state waives sovereign immunity only to the extent that it has entered into an express, valid contract and that the public purse should be guarded from claims for damages on other theories.

Many courts have held that a public body cannot be held liable to a contractor on a *quantum meruit* theory if an express contract between the owner and contractor is invalid for failure to comply with the competitive bidding law.¹²¹

VII. EXEMPLARY DAMAGES

Exemplary damages, also known as punitive damages, are damages awarded in addition to actual damages when the party liable for damages acted in some especially reprehensible way. The right to exemplary damages may arise either under the common law or by statute. The general understanding of punitive damages is that they are intended both to punish wrongdoing and to make an example of wrongdoers so as to deter others from similar conduct.

Under common law, the traditional and prevailing rule is that “[p]unitive damages are not recoverable for a breach of contract unless the conduct constituting the breach is also a tort for which punitive damages are recoverable.”¹²² For example, injuries to persons and damage to property may be tortious even if they also breach contractual promises to perform work with due care.

Efforts to explain why punitive damages are allowed in tort cases while being excluded in most contract cases sometimes appear strained, but there are practical reasons to support the distinction.¹²³ Due to the latitude typically given to triers of fact in calculating damages, the broad range of potential liability for punitive damages (if widely available in contract cases) would make it highly difficult to calculate and allocate risk in commercial transactions. Compensatory awards of actual damages are much easier to predict and can more effectively

120. *S. Roadbuilders, Inc. v. Lee County*, 495 So. 2d 189 (Fla. Dist. Ct. App. 1986); *Whitfield v. Gilchrist*, 348 So. 2d 39, 497 S.E.2d 412 (N.C. 1998); *Lamesa Indep. Sch. Bd. v. Booe*, 235 S.W.3d 710 (Tex. Ct. App. 2008); *Jean Moreau & Assocs., Inc. v. Health Ctr. Comm’n for County of Chesterfield*, 720 S.E.2d 105 (Va. 2012). The Tucker Act, 40 U.S.C. §1346, waives the federal government’s sovereign immunity.

121. See generally Annotation, *Liability of Municipality on Quasi Contract for Value of Property or Work Furnished Without Compliance With Bidding Requirements*, 33 A.L.R.3d 1164 (1970).

122. RESTATEMENT (SECOND) OF CONTRACTS § 355 (1981); see also *Allapattah Servs., Inc. v. Exxon Corp.*, 61 F. Supp. 2d 1326, 1328 (S.D. Fla. 1999); RICHARD J. BEDNAR, HERMAN M. BRAUDE & JOHN CIBINIC, *CONSTRUCTION CONTRACTING* 783 (1991).

123. See, e.g., CORBIN § 1077, at 380 (“Breaches of contract . . . do not in general cause as much resentment or other mental and physical discomfort as do the wrongs called torts and crimes.”).

be covered by bonds, insurance, and other risk transfer tools that are essential to the orderly flow of commerce.

Although government agencies generally rely on their “sovereign immunity” to bar any liability for punitive damages as a result of their own misconduct, they have enacted a number of laws imposing punitive damages on private parties. Such liabilities can arise either in dealings with the government or in transactions between private parties.

One of the best-known of such statutes at the federal level is the False Claims Act,¹²⁴ which imposes a minimum civil penalty and treble damages on a contractor who knowingly “makes, uses, or causes to be made or used, a false record or statement material to an obligation to pay or transmit money or property to the Government, or knowingly conceals or knowingly and improperly avoids or decreases an obligation to pay or transmit money or property to the Government.”¹²⁵ Punitive damages are imposed both on persons who have actual knowledge of the false information and on those who act in deliberate ignorance of or reckless disregard for its truth or falsity. At the state level, breaches of contract may also constitute violations of laws enacted to protect consumers against unfair trade practices, to punish improper handling of hazardous materials, or even to protect certain favored industries or resources.¹²⁶ As the courts appear to impose tort liability in an expanding range of circumstances, the potential exposure to punitive damages in connection with contract breaches increases correspondingly.¹²⁷

124. 31 U.S.C. §§ 3729 *et seq.* (2009).

125. *Id.* § 3729(1)(G).

126. It is beyond the scope of this book to survey the various states and their respective punitive damage statutes. Most readers are probably already familiar with such damages being available under certain consumer protection statutes and basic environmental statutes in their respective jurisdictions. As an illustration of the last category of laws, states with valuable forestry industries may impose punitive damages on contractors who injure trees on land belonging to others. *See, e.g.*, OR. REV. STAT. § 105.810 (2011); WASH. REV. CODE § 64.12.030 (2011).

127. *See, e.g.*, JUSTIN SWEET, LEGAL ASPECTS OF ARCHITECTURE, ENGINEERING AND THE CONSTRUCTION PROCESS § 6.04 (8th ed. 2009); RESTATEMENT (SECOND) OF CONTRACTS § 355 cmt. b (1981).