



NATIONAL ASSOCIATION OF SURETY BOND PRODUCERS

7735 Old Georgetown Road, Suite 900

Bethesda, MD 20814

Tel: 240.200.1270

Fax: 240.200.1295

www.nasbp.org

The Importance of Mutual Waivers of Consequential Damages Clauses

Parties to construction contracts may ask what are “consequential damages” and why are such damages important to address in the contract through a clause waiving the right to claim them. Consequential damages are those damages suffered by a party which are considered “indirect” and do not flow directly and immediately from a construction contract breach but still result from that breach. For example, if a contractor fails to complete its contractual obligations on time, the project owner, in addition to any direct damages, may claim consequential damages in the form of losses of profits or increases in financing costs. Conversely, if an owner interferes with the contractor’s performance, the contractor, in addition to any direct damages, may claim consequential damages in the form of increased operations costs or losses of business opportunities.

There are, in fact, many types of indirect or consequential damages which may be claimed by either contracting party in the event of the other’s breach, and failure to address the impacts of consequential damages injects uncertainty into their contractual relationship and greatly increases the potential liability and the magnitude of the risks for both parties. For these reasons, mutual waiver of consequential damages clauses are ubiquitous in today’s construction contracts and have been long-time features within the commonly-used, standardized forms published by the American Institutes of Architects and by ConsensusDocs, a coalition of over 40 leading industry associations representing owners, contractors, subcontractors, designers, and sureties. These groups have deemed such waiver clauses as essential to construction industry best practices and in the best interests of advancing construction projects, as their presence in construction contracts provides certainty and clarity to each party’s potential liability.

It is important to note that, in assessing its financial risk and preparing a bid or proposal for a project, a contractor will review, among other matters, the consequential damages exposure on that specific project. When a contractor is faced with broad consequential damages exposure, particularly when such damages are not waived or limited, the contractor--assuming it even wishes to proceed--will insert contingencies into the bid or proposal to account for the substantially higher risk. The effect of these contingencies, of course, is that the owner receives higher bids for the project. Thus, in the context of public work, taxpayers will, in the end, pay more for these construction projects.

Likewise, such higher risk exposure also dampens interest by the contractor community in bidding or proposing on that owner’s projects. Less interest translates to less competition and higher project costs. Simply put, a savvy contractor will not “bet the company” on a single construction contract when other, reduced-risk opportunities are available.

The failure to include or the removal of mutual waiver of consequential damages clauses also is problematic from a surety underwriting perspective, as sureties are not comfortable in issuing bonds for contracts that present broad consequential damages exposures. As consequential damages are, by definition, damages that are not directly caused by a breach of contract but nonetheless result from the breach, they can be quite expansive and substantial and be difficult to foresee in the absence of a clear contractual definition. Such broad risk exposure infuses greater uncertainty in the surety’s underwriting of an interested contractor, as the surety will have reduced confidence in the financial soundness and wherewithal of a particular contractor engaged in projects with substantial consequential damages exposures. Small and disadvantaged contractors may find securing bonds on such projects especially challenging, as these businesses may not have a sufficient level of financial capital on hand to provide the surety with assurances of the firm’s fiscal strength when facing unpredictable consequential damages exposures.

Both contracting parties benefit when contract and project risks are clear from the outset and addressed equitably, and mutual waivers of consequential damages clauses serve that purpose. To ensure that such clauses are understood and contain unambiguous terms, contracting parties always should seek the advice of legal counsel knowledgeable in construction law and prevailing construction practices.