

Legal Pipeline

Be Wary of the Waiver

The importance of understanding cardinal change and consequential damage provisions in a subcontract.



By Steven Nudelman

“Freedom of contract” is an important concept, affecting architects and engineering subconsultants as well as general contractors and subcontractors. When commercial parties enter into a lawful contract after arms-length negotiations, courts try to respect the terms and conditions of the agreement. Courts may assist the parties by enforcing the agreement but courts are loathe to upend the terms of a negotiated business deal.

As one Florida court noted, “[C]ourts are ‘powerless to rewrite [a] contract to make it more reasonable or advantageous to one of the parties ... or to substitute [their] judgments for that of the parties to the contract in order to relieve one of the parties from the apparent hardship of an improvident bargain.’ Underwater Eng’g Servs., Inc. v. Utility Bd. of Key West, 194 So.3d 437, 444 (Fla. Dist. Ct. App. 2016) (citation omitted).

This month’s column looks at two key contracting principles and their effect on freedom of contract: the doctrine of cardinal change and waiver of consequential damages. Both concepts took center stage in the Massachusetts Superior Court case of Turner Construction Company v. MJ Flaherty Company, 34 Mass. L. Rptr. 171, 2017 WL 2218780 (Mass. Super. Ct. 2017).

Background

Turner Construction Co. (“Turner”) was the general contractor for the construction of a 23-story office building in Boston (the “Project”). MF Flaherty Co. (“MJ”), Turner’s HVAC subcontractor, had a \$12.5 million subcontract for its work on the Project. After MJ failed to complete its HVAC work, Turner sued MJ to recover the damages that Turner sustained by having to retain a completion subcontractor for the Project.

This ordinary breach of contract claim gave rise to a more exotic counterclaim by MJ that was the focus of much of the Superior Court’s attention. Specifically, MJ claimed it did not complete its work on the Project as a result of Turner’s failure to pay MJ for the work that it did perform. MJ argued that Turner mismanaged the Project, causing MJ to suffer such significant losses that the company’s overall net worth plummeted by \$6.4 million.

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MJ alleged that there were so many change orders issued on the Project that the total contract price jumped by more than 20 percent. While nobody disputed that Turner had an aggressive Project schedule, MJ claimed the scheduling changes and sequencing had an adverse effect on MJ and increased its costs substantially, making it much harder for the HVAC contractor to perform under the contract. Indeed, MJ contended that the Project changes, when considered cumulatively, were of such scope and consequence that they caused a “cardinal change” to its subcontract with Turner.

Waiver of Consequential Damages

Turner moved for partial summary judgment, seeking to dismiss MJ’s counterclaims to the extent it sought recovery of consequential damages. Turner relied on a clause in the Turner-MJ subcontract which provided as follows:

“Notwithstanding any term or provision herein to the contrary, [MJ] expressly waives and releases all claims or rights to recover lost profit (except for profit on work actually performed), recovery of overhead (including home office overhead) and any other indirect damages, costs or expenses in any way arising out of or related to the Agreement, including the breach thereof by [Turner], delays, charges, acceleration, loss of efficiency or productivity disruptions and interference with the performance of the work.”

The Superior Court granted Turner’s motion, finding that the damages sought by MJ on its counterclaim were precisely the type of indirect, consequential damages that MJ agreed to waive in its subcontract. Turner Constr., 2017 WL 2218780 at *1. The above clause is a unilateral waiver of consequential damages — a waiver by one party only — as opposed to a mutual waiver of consequential damages — a waiver by both parties to a contract. Regardless, waivers of consequential damages are enforceable as a matter of Massachusetts law and parties to a private, commercial construction contract are free to include them as a term therein.

“[C]lauses in construction contracts limiting the right to recover consequential damages have long been recognized and enforced as an appropriate means to ‘limit the expense and unpredictability of construction contract litigation.’” Turner Constr., 2017 WL 2218780 at *1 (quoting Costa v. Brait Builders Corp., 463 Mass. 65, 78 n. 22 (2004)). The freedom of contract that allows MJ to waive consequential damages also allows MJ to seek a higher contract price from Turner when the parties initially negotiated their subcontract.

Cardinal Change

MJ attempted to salvage its counterclaim, without success, by invoking the doctrine of cardinal change in

Legal Pipeline

support of its claim for damages. “A cardinal change is a ‘substantial deviation that changes the nature of the bargain,’ and an alteration ‘so profound’ as to constitute a material breach of contract.” 1A Philip L. Bruner & Patrick J. O’Connor, Jr., *Construction Law* § 4:13 (2018) (citations omitted).

The doctrine of cardinal change has its genesis in federal government contracts; however, it has been adopted by a number of states for private construction projects, including Massachusetts. The underlying premise of cardinal change — “that compensation for costs resulting from an abuse of authority under the changes clause [in a contract] should not be limited by the terms of that clause” — applies to private contracts including changes clauses. *J.A. Jones Constr. Co. v. Lehrer McGovern Bovis*, 89 P.3d 1009, 1020 (Nev. 2004).

“Under established case law, a cardinal change is a breach. It occurs

when the government effects an alteration in the work so drastic that it effectively requires the contractor to perform duties materially different from those originally bargained for.” *Allied Materials & Equipment Co. v. United States*, 569 F.2d 562, 563-64 (Ct. Cl. 1978).

The court in *Turner* was able to sidestep the entire cardinal change analysis by relying on the waiver of consequential damages provision in the subcontract. Once the court found this clause enforceable, it also found that it trumped any finding of cardinal change. This is because if there was a cardinal change to the MJ-Turner subcontract, then MJ would only be entitled to recover “the true value of the services performed, i.e., quantum meruit,” not the consequential or indirect damages MJ was seeking in its counterclaims.

MJ failed to submit any legal authority to support the recovery of consequential damages as a result of

cardinal change. The cases submitted by MJ “apply traditional concepts of equitable relief to situations in which a contract should be set aside because the work performed was different than the work bargained for under the contract. In each case, the court concludes that the party performing the work should be given the opportunity to recover the fair value of its labors. The same concepts apply under Massachusetts law.” *Turner Constr.*, 2017 WL 2218780 at *4.

The *Turner* case is instructive because it emphasizes the power and purpose of the waiver of consequential damages clause in a contract, be it for construction or professional services. In either case, it is a risk-shifting provision that has value to both parties to the contract and it should be negotiated. To the extent possible, the contract price should reflect this value.

Since the contracting parties often do not have equal bargaining position, the party with the weaker position is left with a business decision: Do I accept the project with the clause or do I walk away? This is not an easy decision. Moreover, to the extent the clause is accepted, the parties need to understand the precise limitation on prospective damages. If there is an avalanche of unforeseen changes to the contract scope, resulting in consequential damages, then the doctrine of cardinal change is not the answer, according to the *Turner* case.

Under these circumstances, at best, the aggrieved party that can prove cardinal change will be able to collect the fair and reasonable value of the work performed — often not enough to be made whole and avoid being “buried underneath the avalanche.” ●

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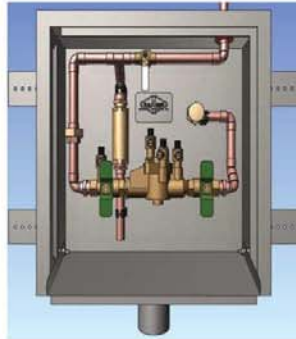
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