

PROFESSIONAL PRACTICE 544

BREACH OF CONTRACT AND REMEDIES; CONSTRUCTION INSURANCE

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Breach of Contract and Remedies, Construction Insurance



WHEN THERE IS A BREACH –
WHAT ARE YOUR REMEDIES?

What is a Breach of Contract?

- ▶ A breach of contract means the failure of a party to perform or fulfill its promise and/or obligations under a contract.

Remedies for Breach of Contract

▶ Purpose of Contract Remedies

- ▶ To put the innocent party in the position he would have been in had the contract been fully performed
- ▶ Purpose is not about punishing the party who breached

▶ Types of Remedies and Damages

- ▶ Legal (monetary damages); Equitable (an action and not monetary)
- ▶ Consequential, Liquidated, and Punitive Damages

Remedies for Breach of Contract

▶ Monetary Damages for Breach of Contract

- ▶ Expectation Damages (making an innocent party whole as if the contract was performed)
 - ▶ The most common type of damage recover theory
 - ▶ The injured party recovers the difference between the cost to complete the contract by another and the agreed-on cost if the original party had performed
 - ▶ The result – you get what you expected for the value to which you agreed

Remedies for Breach of Contract

▶ Monetary Damages for Breach of Contract

- ▶ Reliance Damage (awarded to an injured party who foreseeably relied on a promise – sometimes even an unenforceable promise)
 - ▶ You acted because you relied on a promise by the other party
 - ▶ You get what you deserve based on the promise (e.g., I'll pay for the car you buy)
 - ▶ Also is “I want my money back” remedy – as if the contract was never performed
- ▶ Restitution Damages (awarded where one party has provided a benefit to another, and the first party is compensated for providing that benefit)
 - ▶ Unjust enrichment
 - ▶ Recovery for providing a benefit if the contract was actually performed (e.g., house burned down mid-project)

Remedies for Breach of Contract

- ▶ **Equitable Remedies for Breach of Contract**
 - ▶ Injunction (court order requiring or forbidding an action)
 - ▶ Rescission (undoing the contract and returning both parties to the pre-contract status quo)
 - ▶ Essentially resulting in a resolution “as if the contract never existed”
 - ▶ Rarely sought and/or awarded
 - ▶ Specific Performance (court order requiring the performance of the contract)
 - ▶ Often only for something unique – land is considered unique; cannot have specific performance for services

Remedies for Breach of Contract

▶ Other Types of Damages for Breach of Contract

- ▶ Consequential Damages (indirect damages remotely caused by the breach – they must be reasonably foreseeable when the contract was performed)
 - ▶ Purpose is to cover damages that are the consequences of the breach but that are not identified in the original agreement – e.g., lost profits, loss of business
 - ▶ Often disclaimed in construction contracts
- ▶ Liquidated Damages (typically a per-day \$ value where actual damage later would be difficult to calculate)
 - ▶ Cannot be a penalty
 - ▶ Must bear some reasonable relationship to the likely/potential actual damages
 - ▶ Must be calculated at the beginning of the deal

Remedies for Breach of Contract

▶ Other Types of Damages for Breach of Contract

▶ Punitive Damages

- ▶ Almost never awarded for breach of contract (sometimes for fraud)
- ▶ Punitive damages are similar to paying a criminal fine – however, it is paid to the other party to the contract and not to the State

▶ Legal Fees and Costs

- ▶ Generally not awarded in a breach of contract claim
- ▶ Awardable only if the contract specifically states it is allowable/reasonable

Remedies for Breach of Contract

- ▶ **Mitigation of Damages – The Innocent Party’s Duty to Act “Reasonably”**
 - ▶ A breach by one party does not guarantee recovery for or protection to the other party
 - ▶ Non-breaching party must take steps to minimize its own damages
 - ▶ Often a significant issue in construction cases
 - ▶ Cannot not take advantage of the fact that the other party breached the contract



INSURANCE

Insurance

▶ Professional Liability Insurance (Errors & Omissions)

- ▶ Coverage for claims of negligent errors or omissions by Architect
- ▶ Key terms and concepts
 - ▶ Coverage Limit - The maximum that the policy will pay on account of a claim
 - ▶ The policy pays any loss and pays an attorney to defend the Architect
 - ▶ E&O policies (and others) are “declining balance” policies, so costs paid for defense diminish the amount available to pay or settle a claim
 - ▶ Deductible - The amount that Architect must pay from its own pocket before the insurance proceeds apply
 - ▶ Retroactive Date - The earliest date of Architect’s error or omission for which coverage will apply
 - ▶ Premium - Annual payment an Architect makes to the insurer to “buy” the policy

Insurance

- ▶ **Professional Liability Insurance (errors & omissions)**
 - ▶ The policy is a “claims made” policy, which means that it covers all claims made within the policy year
 - ▶ Because a claim may be made after a project is completed, the insurance only provides protection if it is kept in place
 - ▶ Architects who are retiring or going out of business may purchase “tail policies” which protect against claims made arising out of prior projects even though no further insurance is being purchased
 - ▶ Deductibles are quite large, particularly for Architects with large practices who have been in business for a long time
 - ▶ Premium a function of coverage limits, deductible, and claims history – similar to how your auto policy may be figured

Insurance

▶ Professional Liability Insurance

- ▶ Claims must be reported promptly
 - ▶ Claims made to the insurance broker
 - ▶ Claims made to the carrier
- ▶ The lawyer hired by the insurance company to defend the claim owes his duties of loyalty to Architect, not the insurance company
 - ▶ The lawyer is probably retained frequently by the insurance company and will have strong business ties to it
 - ▶ If a conflict of interests with the insurance company, Architect may have two lawyers
 - ▶ One looks out for Architect's interests, while the other looking out for the insurer's interests

Insurance

▶ Professional Liability Insurance

▶ Practice v. project policies

- ▶ The typical professional liability insurance is a practice policy. It covers all claims for professional errors or omissions made against Architect during the course of the policy year arising out of Architect's practice
- ▶ Alternative insurance is a "project policy." This provides insurance for all professional liability claims against the design professional arising out of a particular project
- ▶ One reason for the popularity of project policies is that the premiums for them can often be directly passed through to Owner as a cost of the project
- ▶ Practice policy costs needs to be factored into the overhead numbers when bidding a project
- ▶ Contractors and their policies, including pass-through costs are a bit different

Insurance

- ▶ **Commercial General Liability Insurance - The Architect**
 - ▶ When purchased by Architect, it covers claims of liability not arising out of professional services
 - ▶ These claims are rare on the typical construction project. Some examples might be:
 - ▶ A client trips and falls on a rug in Architect's office
 - ▶ Architect's construction site observer accidentally bumps into someone and injures him
 - ▶ Because this insurance responds to very few risks, it is not very expensive
 - ▶ It is written on an "occurrence" basis, rather than a "claims made" basis, so it covers all claims arising out of actions that occurred during the policy year

Insurance

▶ Commercial General Liability Insurance - The Contractor

- ▶ When purchased by contractor, it is the major source of protection against claims by injured workers or for calamitous property damage
 - ▶ The general contractor names Owner and Architect as additional insured parties under the insurance
 - ▶ This provides important coverage for Owner, but its coverage for Architect is illusory
 - ▶ When a claim for a construction worker injury or property damage is made against Architect, it is generally deemed to be a claim for professional liability
 - ▶ An exclusion exists in the commercial general liability policy for claims alleging professional liability, so Architect has no coverage under the policy
- ▶ Policies cover claims alleging sudden and dangerous occurrences resulting in property damage or bodily injuries, but not solely economic loss or repair/replacement costs due to bad workmanship

Insurance

▶ **Automobile Liability Insurance**

- ▶ Very similar to general liability policies except they cover accidents arising out of the use of a car
- ▶ These policies are simply commercial versions of the automobile insurance policies that virtually every individual has on his or her own automobile
- ▶ Anyone who drives to the construction site, including both Architect and Contractor, purchase these policies and keep them in place essentially constantly

Insurance

▶ **Builder's Risk Insurance**

- ▶ This is a policy that covers the actual construction work being performed on the site: The work in place, materials stored on site, etc.
- ▶ It may be purchased either by Owner or by Contractor, but the policy names both as insured parties
- ▶ Unlike the liability policies described above, builder's risk insurance is no-fault property damage insurance
 - ▶ Covers damage to the work in place regardless of whether anyone was at fault in causing it
- ▶ The danger to an Architect is that the builder's risk insurer may pay off a loss, and then turn around and sue Architect for having negligently contributed to the problem

Insurance

▶ Builder's Risk Insurance

- ▶ Danger to an Architect is that the builder's risk insurer may pay off a loss, and then turn around and sue Architect for having negligently contributed to the problem
 - ▶ The insurer is "subrogated" to Owner's (and possibly the contractor's) rights against Architect after paying a loss. Essentially, the courts deem that the insurer "steps into the shoes" of the insured parties to the extent of the payment
 - ▶ This appears to be fundamentally unfair, as the basis for calculating coverage costs is a "no-fault" assumption
 - ▶ Architect can ensure that the builder's risk insurer cannot sue Architect by being named as an additional insured party under the policy or else by having Owner (and possibly the contractor) waive their rights of subrogation in their contracts

Insurance

▶ Workers' Compensation Insurance

- ▶ Employers customarily purchase this insurance to protect against a bodily injury claim by the employer's own employees
- ▶ Several statutes passed by the state that require this insurance and that set minimum levels of coverage
- ▶ Worker's compensation laws are the exclusive remedy that an injured employee has against its own employer – but not against 3rd parties
 - ▶ Damages that an employee receives through this process is usually far smaller than what it would receive from a jury in court
 - ▶ Common for the employee to sue everyone for negligently causing the injury except his employer – as that is the workers' comp claim
 - ▶ Workers' compensation laws make it difficult for the parties who have been sued by the employee to bring the employer into court to bear its fair share of the loss

Insurance

▶ Certificates of Insurance

- ▶ To prove that the insurance policies were purchased and coverage is in place
- ▶ Prepared by insurance brokers describing the basic terms of the insurance coverage
- ▶ Often is Architect's responsibility to collect, examine, and forward the insurance certificates provided by the construction team
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- ▶ If complex issues regarding coverage arise, you must examine the actual policies



QUESTIONS