FACING THE CONSEQUENTIALS:
How to Recover, Negotiate and Waive Consequential Damages

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Table of Contents

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Vilification (or, Introduction)[2]

This paper is about contractual consequential damages. It follows a speech and paper that Will Allensworth delivered at the 30th Construction Law Conference. *That* paper covered the nuts and bolts of direct versus consequential damages. If that kind of thing blows your hair back, e-mail us and we will send you a copy. Although we briefly retread some of that content here, the purpose of *this* paper is not to meander down worn paths.

Instead, this paper mainly concerns recent developments in the law on contractual consequential damages and how they affect your clients' ability to recover or rebuff those damages. We begin with a brief primer on consequential damages, then turn to some minor updates to the law of consequential damages from case law from just the last few years.[3] We will analyze a growing and potentially major development arising out of the monumental *Zachry* case, and how that has changed the consequential damages landscape. Finally, we will construct a Frankenstein's monster piece-by-piece for a supreme consequential damages waiver that will be impractical for civil society or inclusion in any actual construction contract, though hopefully you or your clients will be able to dissect its individual parts to get the most out of your own waivers.

We welcome feedback and questions. Please enjoy.

Syntax (or, the boring Black Letter Law)

If you have a passing familiarity with the common law concepts of direct versus consequential damages and their recoverability, you can probably just skip this section.

Damages recoverable at common law are called actual damages. *Arthur Anderson & Co. v. Perry Equip. Corp.*, 945 S.W.2d 812, 816 (Tex. 1997). Actual damages fall into

[1] The authors thank (1) our firm's E-Discovery Project Manager (and Prezi Pro) Christine Davitt, for her help with the materials and presentation, and (2) Marilyn Soltau, for her grace under fire and unimaginable patience.

[2] We cheaply ripped the headings from the cult classic and cinematic masterpiece *Clerks* (1994). Even for readers familiar with the movie, they will confuse you and will not help in navigating the paper. But the structure delights the authors, which is also important.

[3] The case updates are limited to those published from January 1, 2017 to present. While the paper doesn't discuss every case, there is an appendix at the end that lists the recent consequential damages cases with an accompanying summary of each. We probably have not captured *every* consequential damage case, but we gave it the old college try.

two mutually exclusive categories: direct and consequential. Direct damages are ones that flow "naturally and necessarily from the wrong" that the plaintiff is angry about. *Id*. They exist to compensate the plaintiff for damages that the defendant is "conclusively presumed" to have foreseen. *Id*. Because of this presumption, the plaintiff need not prove that the damages are foreseeable, foreseen, forewarned about, or anything else. The plaintiff just gets them.

Consequential damages are like direct damages in that they "result naturally" from the wrong the plaintiff is angry about. *Id*. But unlike direct damages they do not result "necessarily" from the wrong the plaintiff is mad about. *Id*. They are not recoverable unless they are foreseeable and "directly traceable to the wrongful act and result from it." *Id*. Besides proving up the damages themselves, the plaintiff must also prove that the damages were foreseeable. We acknowledge that such labels are unhelpful.

These categories are common law categories and not limited to contract. In fact, most of the Texas Supreme Court cases addressing direct versus consequential damages are not contract cases. *Arthur Andersen*, for example, was really a DTPA case. *Id*. at 814. As construction lawyers, we care more about contract damages. In contract, the "wrong" the plaintiff is mad about is breach, and direct damages are those "inherent in the nature of the breach of the obligation between the parties[.]" *Powell Elec. Sys., Inc. v. Hewlett Packard Co.*, 356 S.W.3d 113, 118 (Tex. App.—Houston [1st Dist.] 2011, no pet.). Contractual, recoverable consequential damages must be foreseeable, and the parties must have "contemplated at the time they made the contract that such damages would be a probable result of the breach." *Stuart v. Bayless*, 964 S.W.2d 920, 921 (Tex. 1998). The foreseeability requirement "is a fundamental prerequisite to the recovery of consequential damages for breach of contract." *Basic Capital Mgmt., Inc. v. Dynex Commercial, Inc.*, 348 S.W.3d 894, 901 (Tex. 2011).

The distinction between tort (as one example) and contract is important. Courts judge foreseeability based on what the plaintiff and the defendant had in mind based on their course of dealings. In the tort context, the plaintiff and defendant may not have many dealings. If a defendant negligently plows into the plaintiff's car on the highway, the parties may not have even had the pleasure of meeting first. In commercial construction contracts, the parties usually have had extensive dealings, including negotiating contract documents delineating what each expects of the other. What these contracts say influences whether damages are direct or consequential, whether they are recoverable if consequential, or whether the parties waived them. Thus, in the contract context, you cannot begin an analysis of direct versus consequential damages without reference to what the contract says. And since no two contracts are identical, the determination is necessarily case-by-case.

Foreseeability has its own set of complicated rules and standards, which are not always consistent. Although there are recent developments that speak to proving up

foreseeability, the law has not changed paradigmatically since the last paper. Although courts evaluated foreseeability on *both* subjective (knew, actually foreseen) and objective (should have known, ordinarily foreseen) bases, the latter dominates. The previous paper addressed the split more definitively than this one and we refer readers to it for a more exhaustive discussion of foreseeability. With one caveat. For foreseeability, the Texas Supreme Court has said repeatedly that to be recoverable, the damages must be foreseeable "at the time" the parties contracted. *Stuart*, 964 S.W.2d at 921; *Basic Capital*, 348 S.W.3d at 903. That said, it has since come to the authors' attention that "some older cases have treated knowledge acquired during the course of performance as sufficient to render a consequential loss foreseeable." Yvonne Ho, *A Consequential Matter: Differentiating Between Direct and Consequential Damages*, STATE BAR OF TEXAS BUS. DISP. CONF., 2019 Bus. Disp. 10-II. For example, over one-hundred years ago the Texas Supreme Court refused to apply the "rule requiring notice at the time of the contract" and held that it did not apply to a plaintiff who wanted to feed cake to his cows. *Bourland v. Choctaw, O. & G. Ry. Co.*, 90 S.W. 483, 485 (Tex. 1906). At least that's what we think it says. Cases from that long ago are incomprehensible and deserve to die in desuetude.[4] If you're trying to get around the "at the time" of contract rule, now you have a case to cite. The recent cases affecting foreseeability analysis, proof, and so on are addressed in the appendix.

Since no two contracts are the same, no two direct versus consequential damages analyses are the same. Most of the judicial analysis on consequential damages is at the intermediary appellate level. Generally, intermediary appellate courts analyze specific provisions of contracts, at least trying to explain their conclusion based on what the parties promised each other. In contrast when the Texas Supreme Court Justices address consequential damages, they focus mostly on broad categories. We think they like categories because categorical rules are more easily administered. The problem is that since it matters a great deal what contracting parties put into their contracts, categories broadly asserted (often in dicta) obscure more than they illuminate. Bear that in mind before reading too much into any individual case.

One last issue on pleading, proving, and recovering consequential damages. Consequential damages are "special" damages that must be specifically pleaded. *Henry S. Miller Co. v. Bynum*, 836 S.W.2d 160, 164 (Tex. 1992) (Phillips, C.J., concurring) ("In order to be recoverable, however, consequential damages must be specifically pled."); Tex. R. Civ. P. 56 ("When items of special damage are claimed, they shall be specifically stated."). This one can hurt. In *AES Valves, LLC v. Kobi International, Inc.*,[5] the plaintiff

[4] "The past is a foreign country: they do things differently there." L.P. Hartley, THE GO-BETWEEN 17 (1953).

[5] No. 01-18-00081-CV, 2020 WL 1880781, at *2, 7 (Tex. App.—Houston [1st Dist.] April 16, 2020, pet. filed) (memo. op.).

took a default judgment against the defendant for over $25M, including around $4.5M in consequential damages. But the plaintiff did not specifically plead consequential damages. *Id*. at *7. The court of appeals held that the plaintiff's failure to specifically plead the damages was fatal and remanded for a new trial (since it was a default judgment case). *Id*. at *8.

Compare that result to the one in *Nelson v. Vernco Construction, Inc.*, 566 S.W.3d 716 (Tex. App.—El Paso 2018, pet. denied, judgm't set aside). There, the plaintiff failed to specially plead $350K in consequential damages under Texas Rule of Civil Procedure 56. *Id*. at 764. Although the defendant orally objected to including consequential damages at the jury charge conference, defendant had not objected "in writing" to the plaintiff's failure to plead special damages. *Id*. (citing Tex. R. Civ. Proc. 90 ("Every defect, omission or fault in a pleading either of form or of substance, which is not specifically pointed out by exception *in writing* and brought to the attention of the judge in the trial court before the instruction or charge to the jury . . . shall be deemed to have been waived") (emphasis added)).

How to explain these results? Since *AES* was a default judgment case, it's probably a safe assumption that the defendant ignored Rule 90. Yet that did not affect the outcome. By contrast, when the defendant orally objects, Rule 90 governs to excuse the plaintiff's failure to plead? We cannot reconcile these two holdings. The practice pointer here is *always* specifically plead consequential damages under Rule 56 and *always* specially except to the plaintiff's failure to do so under Rule 90.

Vagary (or, see what Governmental Immunity[6] has wrought)

Ordinarily, consequential damages cases are hard to come by. Private parties seldom get to appeal until after trial and since consequential damages are usually only *part* of the plaintiff's claims, rarely will a consequential damages summary judgment dispose of an entire case. Even if the parties make it to judgment, it is scarily easy to waive arguments over consequential damages. If the parties arbitrate, there probably will not be an appeal at all. Getting an answer from a Texas appellate court on whether private parties' damages are direct, consequential, foreseeable, or whatever, takes a lot of work, perseverance, and luck.

Governmental immunity cases are a different animal. Immunity speaks to a court's subject matter jurisdiction. *Zachry Const. Corp. v. Port of Houston Auth. of Harris Cty.*, 449 S.W.3d 98, 105 (Tex. 2014). It is not waivable. *Texas Ass'n of Bus. v. Texas Air*

[6] Here, we use "Governmental Immunity" to apply even to instances of "Sovereign Immunity", mostly to annoy our colleague Amy Emerson, a notoriously pedantic immunity expert. We acknowledge that the terms refer to similar but distinct concepts. *Wichita Falls State Hosp. v. Taylor*, 106 S.W.3d 692, 694 n.3 (Tex. 2003).

Control Bd., 852 S.W.2d 440, 443–44 (Tex. 1993). Courts must take it up sua sponte on appeal, for the first time, even if the parties forgot about it at trial. *Id*. at 446. If the parties do raise it in the trial court, any order granting or denying a plea to the jurisdiction, or summary judgment based on immunity, is immediately appealable. Tex. Civ. Prac. & Rem. Code §§ 51.014(a)(5) (summary judgment); 51.014(a)(8) (plea to the jurisdiction). The interlocutory appeal can stay the trial proceeding, so parties often push hard for an appellate decision. *Id*. at § 51.014(b). Since 2015, Texas intermediate courts of appeals have issued over 900 decisions addressing immunity. Jonathan G. Brush and Liz M. Rice, *Governmental Immunity Update*, 35TH ANNUAL UNIV. OF TEX. SCHOOL OF LAW CONFERENCE (February 20, 2020). The Texas Supreme Court *obsesses* over immunity, so governmental immunity disputes make lots of law.

The statutes waiving governmental immunity all specifically exclude consequential damages from their ambit.[7] These exclusions "define the scope" of the waiver. *Zachry*, 449 S.W.3d at 107–8. Texas appellate courts routinely take up consequential damages analyses, and the upside is we get lots of decisions. The downside is that governmental immunity law (with its hundreds of opinions and poorly drafted waiver statutes) now infects the law on consequential damages. That does not really benefit the development of consistent consequential damages jurisprudence.

To understand the holdings in governmental immunity/consequential damages cases, you need to understand some nuance about the structure of the waiver statutes themselves. They all have generally the same structure. First, they waive immunity for certain contracts.[8] Then they set forth the damages that you can recover, typically incorporating the balance due and owing under the contract, *including* (this is important, more on it later) compensation for work directly resulting from owner-caused delays.[9]

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[7] Tex. Loc. Gov't Code § 262.007(c)(1); Tex. Loc. Gov't Code § 271.153(b)(1); Tex. Civ. Prac. & Rem. Code § 114.004(b). We intentionally did not include Tex. Gov't Code Chapter 2260 because it is not a waiver of governmental immunity. Tex. Gov't Code § 2260.006. Though it too specifically prohibits administrative recovery of consequential damages. *Id*. at § 2260.003(c)(1).

[8] Tex. Loc. Gov't Code § 262.007(d); Tex. Loc. Gov't Code § 271.152; Tex. Civ. Prac. & Rem. Code § 114.003. Section 262.007(d) is the least clear waiver. It confusingly begins by stating that the section waives nothing, "other than a bar against suit based on sovereign immunity." But it is a waiver. *Zachry*, 449 S.W.3d at 122 (describing § 262.007 as "a limited waiver of immunity for certain breach of contract suits against Texas counties").

[9] Tex. Loc. Gov't Code § 262.007(b)(1); Tex. Loc. Gov't Code § 271.153(a)(1); Tex. Civ. Prac. & Rem. Code § 114.004(a)(1). The statutes contain subtle distinctions that we do not exhaustively address. As one example, the state agency waiver (Tex. Civ. Prac. & Rem. Code § 114) only permits recovery of owner-caused delays if the "contract expressly provides for that compensation." The Local Government Code waivers do not have that "expressly" language.

Then the statutes except consequential damages.[10] The Local Government Code consequential damages exceptions both have similar carve-outs. In both instances the statutes say the damages awarded cannot include consequential damages "except as . . . allowed" by the earlier provision concerning balance due and owing, and owner-caused delays.[11]

Later in the paper we will dive into how the language above played out in *Zachry*, at least for Section 271.153. In the meantime, note that the Local Government Code waivers assume that there are some types of consequential damages which are waived and therefore recoverable. Otherwise, the phrase "consequential damages, *except as . . . allowed* [in a separate provision of the statute]" would make no sense. (Although as we will see later, there is little about the statutes that makes straightforward sense.)

Purgation (or, dispensing with the Governmental Immunity cases)

In the past five years courts issued over a half-dozen consequential damages opinions in the governmental immunity context, all of which are discussed in the appendix. Because these cases are going up on appeal more often than private party disputes, we expect that soon they will dominate consequential damages jurisprudence. We included brief discussions of particularly unhelpful decisions below. Why the unhelpful ones? This section is a warning. What each of these cases has in common is that they mention and discuss consequential damages but are really about something else, though it can be hard to tell that without really looking under the hood. Do not be fooled. These are not the cases you are looking for. The ones you are looking for are in the appendix, sorted by topic and annotated with brevity to direct readers quickly and effortlessly to the meat of the decisions.

We start with *County of Galveston v. Triple B Services, LLP*, 498 S.W.3d 176 (Tex. App.—Houston [1st Dist.] 2016, pet. denied). The facts are straight-forward enough. Galveston County hired Triple B for a road expansion project. *Id*. at 179. Triple B's contract had a baseline schedule that anticipated unhindered access for the location of utilities, along with provisions for "delay damages." *Id*. The County purportedly delayed moving utilities that put Triple B's schedule off by a year. *Id*. To its credit, Triple B did not miss its completion date, but incurred overage costs including more labor, field office overhead, and so on. *Id*. After the project was over, Triple B sought its overage costs as "disruption damages." *Id*. The County contended that "disruption damages" were

[10] Tex. Loc. Gov't Code § 262.007(c)(1); Tex. Loc. Gov't Code § 271.153(b)(1); Tex. Civ. Prac. & Rem. Code § 114.004(b)(1).

[11] Again, pay heed to nuance. Section 271.153(b)(1) excepts damages that are "*expressly* allowed" in the balance due and owing section, while Section 262.007(c)(1) says basically the same thing but omits "expressly". Texas Civil Practice and Remedies Code § 114.004(b)(1), thoughtfully keeps it simple, by excluding consequential damages entirely.

consequential *and* distinct from the waiver for "balance due and owed . . . for the increased cost to perform the work as a direct result of owner-caused delays or acceleration." Apparently, the County's position was bolstered by Triple B's expert testifying about a distinction between "delay" and "disruption" damages, and that he found only the latter. *Id*. at 179–80. Probably because of the involvement of experienced construction lawyers on the case, the court dove into an interesting discussion of the subtle difference between disruption and delay damages, and how that interacted with the waiver statute. *Id*. at 181–82.

Most of this analysis should have been limited to a straight-forward discussion of Section 262.007(b)(1), and specifically whether disruption damages constitute compensable damages "for the increased cost to perform the work as a direct result of owner-caused delays or acceleration[.]" Tex. Loc. Gov't Code § 262.007(b)(1). But the County alleged that Triple B's damages included consequential damages that were excluded from the waiver. *County of Galveston*, 498 S.W.3d at 181. Ordinarily a court, forced to confront weighty issues like what damages are direct versus consequential, has the benefit of a fully developed record. But rarely so in immunity cases, since they go up on pleas to the jurisdiction that often are based exclusively on the pleadings, or a narrow record. *Id*. at 185 (stating that the "record here is not developed enough" to empower the court to determine whether all the damages claimed by Triple B fell within the immunity waiver).

Forced to decide on that narrow record, the court held that "at least some of Triple B's damages" were waived by the statute. *Id*. It also opined:

> But some of Triple B's damages do not appear to be costs that were directly caused by the County's delay—for example, Triple B's damages model includes lost profits, which are a typical example of a non-direct, consequential damage and, thus, are not a cost incurred by Triple B as a direct result of the County's delay.

Id. This is a problem because the court is conflating two issues. If you blink, you might miss it. First, it lazily assumes that lost profits are "a non-direct consequential damage[.]" *Id*. It is true that lost profits can be consequential. Plenty of cases say so, particularly when the loss is profits the plaintiff would have enjoyed from *other* contracts.[12] And when the

[12] *Kiewit Offshore Servs., Ltd. v. Dresser-Rand Global Servs., Inc.*, No. H-15-1299, 2016 WL 4564472, **9–10 (S.D. Tex. Sept. 1, 2016) (holding that under Texas law damages resulting from third-party contracts were consequential and not direct); *Cherokee Cty. Cogeneration Partners v. Dynegy Mktg. & Trade*, 305 S.W.3d 309, 314 (Tex. App.—Houston [14th Dist.] 2009, no pet.) (stating that "profit lost on other contracts or relationships resulting from the breach may be classified as . . . consequential damages"); *Mood v. Kronos Prods., Inc.*, 245 S.W.3d 8, 12 (Tex. App.—Dallas 2007, no pet.) (classifying "profits lost on other contracts or relationships resulting

Texas Supreme Court discusses lost profits, it often assumes them to be consequential.[13] But courts often treat lost profits as direct damages. "Lost profits can take the form of direct or consequential damages" and "[p]rofits lost on the breached contract itself are" direct. *Tennessee Gas Pipeline Co. v. Technip USA Corp.*, No. 01-06-00535-CV, 2008 WL 3876141, at *11 (Tex. App.—Houston [1st Dist.] Aug. 21, 2008, pet. denied).[14] For example, imagine a construction contract that entitles a contractor to lost profits on work *not performed* if the owner wrongfully terminates the agreement. Also imagine that the contract precisely calculates profits the contractor is entitled to in the event of that termination. How can a specific, mutually accepted and bargained for remedy *not* be a direct damage arising "naturally and necessarily from" the precise breach contemplated?[15]

Back to *County of Galveston*. The court, having made its assumption about lost profits, plunged into its second error, and concluded that because lost profits were consequential, they were "thus . . . not a cost incurred by Triple B as a direct result of the County's delay." *County of Galveston*, 498 S.W.3d at 185. This is a false dichotomy. As we will see shortly, the Texas Supreme Court in *Zachry* held that damages for "owner-caused delays" could be recovered *even if they are consequential damages*. *Zachry*, 449 S.W.3d at 112 (holding that statute waived immunity for "contract damages, including

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from the breach" as consequential). The O.G. consequential damages case, *Hadley v. Baxendale*, 9 Exch. 341, 156 Eng. Rep. 145 (1854), classified lost profits as consequential.

[13] *J & D Towing, LLC v. Am. Alternative Ins. Corp.*, 478 S.W.3d 649, 655–56 (Tex. 2016) (treating loss-of-use damages as consequential, and including "the amount of lost profits" as one measure of loss-of-use); *Phillips v. Carlton Energy Group, LLC*, 475 S.W.3d 265, 278 (Tex. 2015) ("With respect to the recovery of lost profits as consequential damages…"); *Basic Capital Mgmt., Inc. v. Dynex Commercial, Inc.*, 348 S.W.3d 894, 901 (Tex. 2011) ("We turn to the second issue addressed by the court of appeals: whether Basic is precluded from recovering lost profits as consequential damages…"); *Tooke v. City of Mexia*, 197 S.W.3d 325, 346 (Tex. 2006) ("Their only claim is for lost profits, which are consequential damages excluded from recovery under the statute."). Note that *Tooke* is also an immunity case. *See also DaimlerChrysler*, 362 S.W.3d at 183 (distinguishing *Tooke* because it "did not involve common law consequential damages" and treating its holding as limited to the immunity statute).

[14] *See also Cont'l Holdings, Ltd. v. Leahy*, 132 S.W.3d 471, 475 (Tex. App.—Eastland 2003, no pet.) (holding that profits lost on the breached contract itself, such as amounts party would have received on the contract less its saved expenses, were direct and not consequential damages); *DaimlerChrysler Motors Co., LLC v. Manuel*, 362 S.W.3d 160, 183 (Tex. App.—Fort Worth 2012, no pet.) ("There is no bright-line rule that lost profits always constitute consequential damages under the common law").

[15] The AIA A201-2017 treats the contractor's "anticipated profit arising directly from the Work" as a direct damage, or at least not a consequential damage, since that element is excluded from the consequential damage waiver. AIA A201-2017 at 15.1.7.2.

delay damages, but excluding *other* consequential damages.") (emphasis added). How did the court get this so wrong? *County of Galveston* was less than two years after *Zachry* and cited the latter over a dozen times.

We do not think the court got it wrong, at least in its holding. The court, on a limited record, was asked to determine whether a party had asserted more than $0 of waived damages. Being obligated to "construe the pleadings liberally in favor of the plaintiff" the court merely held that there were some waived damages, and *maybe* some not waived damages. *County of Galveston*, 498 S.W.3d at 185. The latter was noisy and unnecessary dicta, but the court can hardly be blamed for issuing noisy and unnecessary dicta when the source material (other holdings) is so full of noisy and unnecessary dicta. And that is our point. When you are researching consequential damages, be weary of immunity cases. They mean well but show up with baggage.

Another example, though not in the construction context. In *La Joya Indep. Sch. District v. Trevino*,[16] La Joya ISD and Albert Trevino entered into an insurance consulting services agreement. *Id*. at *1. For compensation, the agreement entitled Trevino to commissions and other fees. *Id*. The contract had a termination provision entitling La Joya ISD to terminate Trevino for good cause, so long as it provided notice and a chance to cure. *Id*. Trevino contended that La Joya ISD terminated him in breach of the notice and opportunity to cure provisions and sued to recover the compensation he would have received over the life of the agreement had La Joya ISD not terminated. *Id*. Predictably the parties disagreed over whether these damages were direct (and therefore recoverable) or consequential (and therefore not recoverable). *Id*. at *2.

Trevino's main problem is that the Texas Supreme Court basically decided this case years before in *Tooke v. City of Mexia*, 197 S.W.3d 325 (Tex. 2006). There, a brush collection contractor sought profits it would have made on a prematurely terminated city contract. *Id*. at 329–30. None of the profits were for work performed; the contractor was seeking profits exclusively on work *not* performed. *Id*. at 330. Without much discussion (at least on this narrow issue; consequential damages are only mentioned in the opinion three times) the Texas Supreme Court held that lost profits were consequential damages excluded from the waiver. *Id*. at 346.

Returning to *La Joya*, *Tooke* decided the case. The Court held that since Trevino (like the plaintiffs in *Tooke*) was only seeking consequential lost profits: money for work "he would have earned for future services rendered[.]" *La Joya*, 2019 WL 1487358 at *5. In a footnote, the court rejected Trevino's argument that his damages were direct:

[16] No. 13-17-00333-CV, 2019 WL 1487358 (Tex. App.—Corpus Christi April 4, 2019, pet dism'd) (memo. op.).

> We reject Trevino's contention that his damages should be categorized as direct damages in the form of lost earnings. Trevino's supporting authority in this regard is inapposite as it pertains to employment contracts between private parties. As stated above, the subject contract is a services contract with a governmental entity.

Id. at *5 n.8.

The court's distinction hints at the problem: immunity cases are just different because they involve a "governmental entity" *Id*. There is no doctrinal reason why consequential damages mean something different when private versus public entities are involved. And besides this opinion, we are unaware of any case similarly treating consequential damages as different just because a public entity is involved. Put differently, the court's dodge is either an unpersuasive red car/green car distinction, or it really is the case that consequential damage analyses in immunity cases is a distinct species.

There is another reason to think that immunity cases are just different. Governmental entities have no power to waive their own immunity, only the Legislature can do so. *Texas Natural Res. Conservation Com'n v. IT-Davy*, 74 S.W.3d 849, 857 (Tex. 2002) ("Because we have consistently held that only the Legislature can waive sovereign immunity from suit, allowing other governmental entities to waive immunity by conduct that includes accepting benefits under a contract would be fundamentally inconsistent with our established jurisprudence[.]"). But that oversimplifies the issue; the Legislature has waived immunity *if* a governmental entity engages in certain conduct, like "enter[ing] into a contract subject" to a waiver statute. Tex. Loc. Gov't Code § 271.152. At common law, whether damages were direct versus consequential has *something* to do with what the contract says. But if a governmental entity can shrink the universe of consequential damages by agreeing to certain things in its contract, is the governmental entity functionally empowered to shrink (and therefore waive) its own immunity (which it cannot do)? Recall in *Tooke* that the Court reasoned that the "lost profits" claimed by the plaintiff were "consequential damages excluded from recovery under the statute." *Tooke*, 197 S.W.3d at 346. But what if the contract in that case had said: "Tooke's lost profits on work not performed are direct damages, and Tooke will be entitled to them as a direct damage in the event the City prematurely terminates Tooke's contract." Perhaps the reason the Texas Supreme Court is so hung up on *categories* in immunity cases is to prevent governmental entities from functionally waiving, by conduct, large swaths of damages by making them direct in their contracts. Again, questions like these are why it was improvident for the Legislature and courts to tie one immensely complicated area of jurisprudence (common law direct versus consequential damage analysis) with another (governmental immunity). Yet here we are.

We do not think immunity cases are always questionable guideposts in the consequential damages context. The appendix includes immunity cases that do speak to

important issues, like what sorts of promises can never have direct damages. *E.g.*, *Dallas/Fort Worth Int'l Airport Bd. v. Vizant Tech., LLC*, 576 S.W.3d 362, 373–74 (Tex. 2019) (holding that expectancy damages on promise to make a good-faith effort to do something in the future were necessarily consequential, since promise imposed no obligation on breaching party to enter into agreement). But know that they often address deceptively similar issues and beware the dicta. As the next section shows, dicta, especially from the Texas Supreme Court, can upend the law.

Perspicacity **(or, more about *Zachry* than anyone would want)**

Zachry was a monumental construction case. The Construction Law Conference featured a *Zachry*-focused presentation in anticipation of the Texas Supreme Court's decision, and then again two years later.[17] Over a dozen amici curiae, represented by a who is who of the Texas construction bar, submitted briefs in support of the parties and legal arguments presented. Both parties were represented by all stars at the trial and appellate levels. If you are someone who gets excited about construction disputes, this was your Super Bowl. And the opinion delivered. The slimmest 5-4 majority, quarterbacked by Chief Justice Hecht, dueled sharply with a Justice Boyd dissent, with both calling each other out in their opinions.

The case was about the construction of a wharf on the Bayport Ship Channel for the Port of Houston Authority. *Zachry*, 449 S.W.3d at 101. The Port hired Zachry to construct the wharf using an "innovative" plan that involved constructing a U-shaped berm around the wharf. *Id*. Zachry then planned to freeze the berm (to keep the Gulf of Mexico on its side of the bed) and remove the water on the interior side, so Zachry could perform work "in the dry." *Id*. The contract had an extremely tight construction schedule, and a no-damages-for-delay clause nominally foreclosing Zachry's right to any financial compensation for delay, even if caused by the negligence, breach, or other fault of the Port. *Id*. at 102–3. During construction, the Port realized it needed larger berths that would require a change order. *Id*. at 102. Zachry proposed to perform this work in the dry as well. *Id*. Despite harboring (undisclosed) concerns about Zachry's "in the dry" proposal for this new work, the Port signed an approximately $13M change order. *Id*. at 103. But weeks later the Port rejected Zachry's means and methods, asking Zachry to revise its plan without the cutoff walls needed to perform the work dry. *Id*. The parties fought but ultimately the

[17] Jeff Ford, *No Damages for Delay" Does it Actually Mean What it Says?*, 26TH ANNUAL CONFERENCE (Feb. 28, 2013) (on file with the Construction Law Section of the State Bar of Texas); Jeff Ford, *No Damage for Delay? Not so Fast!*, 28TH ANNUAL CONSTRUCTION LAW CONFERENCE (March 5, 2015) (on file with the Construction Law Section of the State Bar of Texas). For good measure, the Section invited Zachry's trial counsel to deliver an excellent speech on the case again in 2018. George E. Bowles and Robin C. Gibbs, *Trial Demonstration: Zachry v. Port of Houston Opening Statement*, 31ST ANNUAL CONSTRUCTION LAW CONFERENCE (March 1, 2018) (on file with the Construction Law Section of the State Bar of Texas).

Port would not budge, and Zachry proceeded with the new method (very much with the Gulf of Mexico now on top of it) under protest, suing during construction. *Id*. Zachry eventually completed the work and sought over $30M in delay damages from the Port. *Id*.

At trial, the jury returned a verdict for Zachry for ~$18.5M in damages. *Id*. at 104. The jury also found that the delays were caused by the Port's "arbitrary and capricious conduct, active interference, bad faith and/or fraud." *Id*. Relying on this finding, the trial court refused to enforce the no-damages-for-delay clause and rendered judgment for Zachry based on the verdict. *Id*. Not a bad day for Zachry. Both sides appealed. The Houston Fourteenth Court of Appeals reversed, holding that the no-damages-for-delay clause barred Zachry's delay damages. *Id*. at 104–5. The court of appeals also reversed and rendered in the Port's favor on a defective wharf fender claim, making it the prevailing party, and entitling the Port to over $10M in attorney's fees. Not a bad day for the Port.

The Texas Supreme Court held that Zachry's claims were not barred by sovereign immunity. *Id*. at 110. It also held that the no-damages-for-delay clause violated public policy, adopting two exceptions to enforcement: (1) "result[ing] from fraud, misrepresentation, or other bad faith on the part of one seeking the benefit of the provision" and (2) "based upon active interference . . . or other wrongful conduct" including "arbitrary and capricious acts . . . willful and unreasoning actions . . . without due consideration . . . and in disregard of the rights of other parties." Both tracked with the jury's verdict *Id*. at 115, 118.

Why do we care? What does vitiation of a no-damages-for-delay waiver have to do with *consequential* damages? A lot, as it turns out. There are two aspects of *Zachry* that we predict will influence the delineation of consequential versus direct damages, and the enforceability of consequential damages waivers. In the case of the former, we believe it is a matter of unnecessary dicta run wild. But the latter speaks to much larger issues affecting freedom of contract generally.

Whimsy **(or, the unfortunate *Zachry* definition of consequential damages)**

We begin by setting up the problem of definitions and what they do to parties, turning then to what *Zachry* said, and then exploring how the Court got there.

Consequential damages waivers are common in construction contracts. When disputes come at us, the waivers are one of the first things we look at to advise clients on what their rights or risks are in the dispute. The sheer volume of damages that may later be characterized by a court as consequential is unimaginable.

When our clients sign contracts with the word "consequential," they do not mean following as an effect, or logically consistent, or even merely of importance.[18] Consequential is a term of art, borrowed from the vast common law. Its original meaning predates any living human, evolves daily, and will probably still be kicking it long after we are all dead. Because it is a legal term of art, the meaning is subject to judicial interpretation and thus legal flux. And because the term belongs to the common law, when courts change their mind about what it means (or tell us what they really meant all along), it can apply retroactively to every party who agreed to waive consequential damages in the meantime. When our clients privately order their affairs through consequential damage waivers, they are adopting the present *and* future meaning of the term, whether they like it or not.

Zachry is not an easy case to read. It has dozens of footnotes and addresses immensely complicated matters of statutory and contractual interpretation. The opinion discusses consequential damages mostly in their relation to Section 271.153 of the Texas Local Government Code. The majority mentions consequential damages less than a dozen times, at least in the body of the opinion. But tucked away in relative obscurity at the end of footnote 71, is this remarkable assertion from the State's highest Court:

> Delay damages are consequential damages.

Id. at 114, n.71. Not, "[d]elay damages *can be* consequential damages." But: all A are B. Delay damages are to consequential damages as horses are to mammals.

So what? Well first we doubt it is true. There are plenty of cases holding that delay damages can be direct.[19] In *County of Galveston*, the court held that the contractor's damages were a "direct result" of a delay so long as they met the definition of direct damages, and the court held they did. *County of Galveston*, at 498 S.W.3d at 185 (*citing Zachry*, 449 S.W.3d at 111 and *Cherokee Cty*., 305 S.W.3d at 314). What the contract says, matters. Damages which would be direct (or "general") "in relation to a contract of one kind may be classified as" consequential (or "special") "in relation to another." *Kerr S.S. Co. v. Radio Corp. of Am.*, 245 N.Y. 284, 157 N.E. 140, 141 (1927) (Cardozo, C. J.).[20]

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[18] Consequential, MERRIAM-WEBSTER DICTIONARY, https://www.merriam-webster.com/dictionary/consequential (last visited Feb. 7, 2021) ("[O]f the nature of a secondary result: INDIRECT").

[19] *Kiewit Offshore Servs., Ltd. v. Dresser-Rand Global Servs., Inc.*, No. H-15-1299, 2016 WL 4564472, at *17 (S.D. Tex. Sept. 1, 2016) (rejecting argument that project impact damages caused by delay were consequential damages); *Tenn. Gas Pipeline*, 2008 WL 3876141 at *8 (treating "Project delay costs" as direct damages).

[20] In *Buffalo Bayou Ship-Channel Co. v. Milby & Dow*, 63 Tex. 492, 496 (1885), the Texas Supreme Court suggested that a defendant's delay of a plaintiff's passage by obstructing a public highway, caused damage that was "direct, as contra distinguished from a damage that is remote

As a practical matter, our clients treat delay damages as direct damages all the time. Construction contracts often stipulate remedies and damages in the event of a delay caused by the other party. If a contract stipulates that the contractor will have a right to its extended field office expenses upon an owner-caused delay, we think that is a direct damage. It would also startle our clients to find out that a routine, boiler-plate consequential damages waiver accidentally waived all damages for delay (since, as the Court said, delay damages are consequential damages).

Sure, that is odd, but maybe we are just overreacting to dicta in a footnote. The problem is that on a careful reading of the opinion, the Court's *conclusion* that delay damages are consequential damages is either (a) not dicta at all (because it is necessary to the Court's resolution of the immunity issue)[21] or (b) persuasive judicial (rather than obiter) dicta from the Texas Supreme Court. [22] In either event it will be followed. Seeing why an obscure statement in footnote 71 is central to, or at least consistent with, the Court's analysis, takes a bit of work.

The main issue the Court confronted was whether Zachry's delay damages constituted a "balance due and owed . . . under the contract . . . *including* any amount owed as compensation for the increased cost to perform the work as a direct result of owner-caused delays or acceleration." *Zachry*, 449 S.W.3d at 106 (citing Tex. Loc. Gov't Code 271.53(a)(1)). Zachry faced two main impediments. First, the contract did not permit any damages for delay. To the contrary, Zachry specifically disclaimed those damages in the no-damages-for-delay clause. Second, even if the clause were struck for public policy reasons, "the contract [did] not provide for or in any way contemplate that the Port. . . would pay for Zachry's delay costs." *Id*. at 120 (Boyd, J., dissenting). The Port's framing, which the majority rejected, was that "no balance [could] be due and owed under a contract unless the contract expressly calls for payment." *Id*. at 111.

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and consequential[.]" The decision is ancient and probably cannot be cited for any comprehensible statement of current law. And the Court might have been discussing causation rather than damages, though it is hard to tell.

[21] *See Seger v. Yorkshire Insurance Co., Ltd.*, 503 S.W.3d 388, 399 (Tex. 2016) (reaffirming definition of dictum as unnecessary to the resolution or determination of a court).

[22] We do not mean "persuasive" in the sense that it persuades us. We are not persuaded, and we think the Court's footnote 71 is **wrong**. But what we think does not matter. Judicial dicta is not necessarily binding precedent, but it is "persuasive and should be followed unless found to be erroneous." *Palestine Contractors, Inc. v. Perkins*, 386 S.W.2d 764, (Tex. 1964).

The reason the issue split the court nearly down the middle[23] is because the statute is poorly drafted. It cannot be given effect without discounting some portion of it or prioritizing dueling canons of interpretation. The warring clauses are below, with the critical portions italicized:

> (a) [The total amount of money a local government entity can recover is limited to the following]:
>
> (1) the *balance due and owed* by the local governmental entity *under the contract* as it may have been amended, *including* any amount owed as compensation for the increased cost to perform the work as a direct result of owner-caused *delays* or acceleration[.]" . . .
>
> (b) [Damages awarded may not include:
>
> (1) *consequential damages*, *except as expressly allowed under Subsection (a)(1)*.

Tex. Loc. Gov't Code § 271.153 (emphasis added). The Court's first step was to dispense with the notion that the "balance due and owed" was limited to "amounts ascertainable from the face of the contract." *Id*. at 111. The Court reasoned that since "delays" could not be "determined in advance, when the contract [was] executed" then there must not be any requirement that the universe of "balance due and owing" damages was "limited to amounts stated in the contract." *Id*. at 111–12.

To support its interpretation, the Court highlighted (b)(1), and specifically the "except as expressly allowed" under the "balance due and owed" section. *Id* at 112. From the Court's perspective, if delay damages were *only* recoverable if stated in the contract, the "except" was mere surplusage,[24] since a plaintiff "could recover all amounts stated in the contract, and all consequential damages stated in the contract." *Zachry*, 449 S.W.3d at

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[23] A 5-4 split at the Texas Supreme Court is unusual since it is such an ideologically consistent Court. In the 2014 term (when *Zachry* was decided), Chief Justice Hecht and Justices Green, Johnson, Willett, Guzman, Lehrmann, Boyd, Devine, and Brown agreed with each other in most cases. For example, the two justices who *disagreed* with each other most in signed opinions that term, Hecht and Boyd (who just so happen to respectively author the majority and dissenting opinions in *Zachry*), still agreed with each other 77.6% of the time. Since 2010, Hecht and Boyd have agreed with each other 82.8% of the time, at least in signed opinions. All statistics taken from SCOTXblog: https://data.scotxblog.com/stats/voting/2020?affinity=jm&scope=split (last accessed by author February 6, 2021).

[24] "[I]nterpretations of contracts as a whole are favored so that none of the language in them is rendered surplusage." *Ewing Const. Co., Inc. v. Amerisure Ins. Co.*, 420 S.W.3d 30, 37 (Tex. 2014).

112. To give effect to (b)(1)'s "except" language, the Court held that (a)(1) permitted recovery of "contract damages, including delay damages, but excluding *other* consequential damages." *Id*. (emphasis added). The Port responded that legislative history undercut this interpretation, but Texas does not generally chase legislative history. *Id*. at 113. Instead, the Court knew what the Legislature "clearly intended": "to limit the recovery of consequential damages on contract claims permitted by the" statute. *Id*. at 114. And *this* is when the Court stated, in a footnote, that "[d]elay damages are consequential damages." *Id*. at 114, n.71.

One quick point. It is not obvious how much the Court's reasoning was driven by the traditional direct versus consequential damages analysis. The Court's arguments about what was "ascertainable" at the time of the contract sounds similar but not identical to typical actual damages analysis. It is unfortunate that an already complicated area of jurisprudence (consequential damages) ended up married to this intensely convoluted statutory interpretation issue in *Zachry*. We doubt the legislature, when it enacted these immunity waivers, intended any change in the legal definition of consequential damages.

The Court's dizzying argument is more than the sum of its parts. Each step was necessary to rebut contrary statutory interpretations raised by the dissent. For a "balance due and owed" to include damages that were unmentioned *or expressly disclaimed* in a contract, the Court had to find that the statute's "balance due and owed" waived immunity for some category of damages similarly unmentioned in the contract. To get there, it relied on the consequential damages exception, and specifically its exception for those damages allowed by (a)(1). Then the Court had to find a category of *consequential* damages that was a "balance due and owed." Otherwise, there is nothing for (b)(1) to except itself from. So the Court relied on the "owner-caused delays" in (a)(1). In this way, "owner-caused delays" ends up modifying "balance due and owed." We will come back to that.

In a compelling dissent, Justice Boyd attacked the Court's reasoning on several grounds. First (and we agree), the Court's emphasis on what was "ascertainable at the time of contracting" is largely a red herring. *Id*. at 128 (Boyd, J., dissenting). From the dissent's perspective, amounts can be *unquantified* at the time of contracting, but certainly contemplated "under the contract" as a "balance due and owed." *Id*. As an example, even if the Court is right that delay damages are not ascertainable at the time of contracting, parties often "agree that the owner will compensate the contractor for owner-caused delays[.]" *Id*. When they do so, those damages should be recoverable even under a "balance due and owed," full stop. *Id*. And we think the same would be true if the analysis were direct versus consequential. If a construction contract contemplates that one party will compensate the other for delays, those damages should be direct. Sometimes Texas courts treat certain delay damages as direct even if the contract does *not* expressly require it. *See, e.g.*, *Tenn. Gas Pipeline*, 2008 WL 3876141 at *8 (awarding owner extended administration costs and expenses as *direct* damages because of contractor's delay, because contract obligated owner to carry those expenses during construction). Even run-of-the-

mill direct damages, like cost of repair under certain contracts, are not necessarily ascertainable at the time of contract since labor and material costs fluctuate.

Second, Justice Boyd attacked the Court's treatment of "including" in (a)(1): 128.

> For example, if a franchise agreement authorized a franchisee to operate 'in any Texas city, including Athens," the agreement would permit operations in Athens, Texas but not in Athens, Greece, or Athens, Georgia. The word 'including' is not a synonym for the word 'and.' It does not expand the meaning of 'any Texas city' to include Athens, Greece, or Athens, Georgia, merely because those cities are also named 'Athens.' Instead, it limits the scope of the reference to 'Athens' to the 'Texas city' by that name.

Zachry, 449 S.W.3d at 128–29.[25] We agree. The Court should not have allowed "owner-caused delay" to modify, define, or expand the phrase "due and owed" to include the opposite. Ordinarily, the statement A including B implies that A includes all those instances of B in which B is also an A. If we ask a friend what we can get him to drink, and he says that he would like an alcoholic beverage, including any beverage brewed by the Coors Brewing Company, we understand him to be saying that he would be happy to have a smooth, crisp, refreshing Coors Light. Coors Light, after all, is an alcoholic beverage brewed by Coors Brewing Company. But if I bring him back a Coors Edge—a *non-alcoholic* beverage brewed by Coors Brewing Company—he will ask us what the malfunction was.[26]

Does any of this matter? We hope not. We hope future courts acknowledge that the loose dicta in *Zachry* was limited to its facts and context. But it will be difficult for lower courts to argue with the Texas Supreme Court's assertion that "[d]elay damages are consequential damages." *Zachry*, 449 S.W.3d at 114 n.71. We would urge your clients to

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[25] The majority accused the dissent of putting the cart before the horse. *Id*. at 113 n.65. They thought a better example would be "a city, including *any* named Athens," which would be a "longer list." *Id*. The dissent thoughtfully reminded the Court that even under its example, "city" would still "not include a corporation, or a person, or pet named "Athens[.]" *Id*. at 128 n.10. We think Justice Boyd has the better argument, but readers can decide for themselves. We also agree with the dissent that if the Court's inclusive definition of "balance due and owed" includes all common law damages for breach, it is hard to see how *Tooke* and its progeny (including *County of Galveston*) remain good law. *Id*. at 126–27.

[26] We acknowledge that under canons of interpretation, the phrase "include" is typically a phrase of enlargement. Antonin Scalia & Bryan A. Garner, READING LAW: THE INTERPRETATION OF LEGAL TEXTS 226 (2012) ("When a definitional section says that a word 'includes' certain things, that is usually taken to mean that it may include other things as well[.]"). But it must have some limits, or else you could get tricked into drinking non-alcoholic beers.

clarify that their boiler-plate consequential damages waivers do not envision waiving all delay damages (unless that is what they want) and have included language below to do so.

Harbinger (or, what *Zachry* means for the future of damage waivers)

Recall that in *Zachry* the jury found that the Port engaged in arbitrary and capricious conduct, active interference, bad faith, or fraud. *Id*. at 104. These terms were defined in the jury instructions to include "willful and unreasoning action," though "more than a simple mistake, error in judgment, lack of total effort, or lack of complete diligence." *Id*. at 104 n.7. Although the Court was skeptical that the no-damages-for-delay clause even applied to this sort of conduct,[27] the Court held that in any event, this no-damages-for-delay clause could not be enforced in the face of the jury's findings, on public policy grounds. *Id*. at 118.

Since the Texas Supreme Court adores freedom to contract,[28] it spent much effort justifying this uncharacteristic invalidation of a negotiated waiver between sophisticated parties. Because of its importance, we include the Court's entire analysis:

> We have indicated that pre-injury waivers of future liability for **gross negligence** are void as against public policy. Generally, a contractual provision "exempting a party from tort liability for harm caused **intentionally or recklessly** is unenforceable on grounds of public policy." **We think the same may be said of contract liability**. To conclude otherwise would incentivize **wrongful conduct** and damage contractual relations. This conclusion is supported by lower court decisions in Texas and court decisions in at least 28 American jurisdictions. We join this overwhelming consensus. The Port argues that the cases from other jurisdictions are inapposite because those jurisdictions all recognize a party's duty of good faith in performing a contract, and Texas does not. But the law need not impose a duty of good faith on a party to prohibit him from

[27] *Id*. at 115 ("As a matter of textual interpretation, it is doubtful whether the rule of *ejusdem generis* would allow 'other fault', following 'negligence' and 'breach of contract', to include the kind of deliberate, wrongful conduct the Port was found by the jury to have engaged in."). On this point, the Court was persuaded by, and (deservedly) complimentary of, Joe Canterbury's amicus brief on behalf of the Associated General Contractors of Texas, Inc. *Id*. at 116.

[28] *See, e.g.*, *Energy Transfer Partners, L.P. v. Enterprise Prod. Partners, L.P.*, 593 S.W.3d 732, 740 (Tex. 2020) (stating that "perhaps no principle of law is as deeply engrained in Texas jurisprudence as freedom of contract."). For more information on this case and its implication for contract law in the future, please see Tracy Russell Galimore, *No Partnership By Ambush – An Overview of Transactional Entities in Construction and Commercial Agreements*, 34TH ANNUAL CONSTRUCTION LAW CONFERENCE (forthcoming March 2021 and will be on file with the Construction Law Section of the State Bar of Texas).

> attempting to escape liability for his **future, deliberate, wrongful conduct**. The Port argues that withholding enforcement of a no-damages-for-delay provision is in derogation of freedom of contract. But that freedom has limits. As a rule, parties have the right to contract as they see fit as long as their agreement does not violate the law or public policy. Enforcing such a provision to allow one party to intentionally injure another with impunity violates the law for the reasons we have explained.

Zachry, 449 S.W.3d at 116–18 (emphasis added, internal citations and quotations omitted).

Although *Zachry* concerned a no-damages-for-delay clause, the language above is much broader. It covers contractual rights to waive more generally, so long as they fall under the exceptions (which seemingly includes gross negligence, and recklessness, in addition to intentional or deliberate acts). Several of the jury instructions *may* have included something like gross negligence or recklessness ("without due consideration and disregard of the facts"), even though no gross negligence instruction was submitted to the jury. *Id*. at 104 n.7. But the Texas Supreme Court opened with gross negligence and included "reckless" conduct in its analysis.

This is a rather major development since it might signal that the Texas Supreme Court will not enforce damage waivers in the face of grossly negligent or reckless conduct. The interplay between mainly tort concepts, like gross negligence, and contract is already an immensely complicated area of law. In traditional gross negligence cases, there is usually a physical injury, and the elements include things like the "degree of risk" or "potential harm" to the "rights, safety, or welfare of others." *U-Haul Intern., Inc. v. Waldrip*, 380 S.W.3d 118, 137 (Tex. 2012). Most of the cases discussing the unenforceability of pre-releasing gross negligence speak to *injury*, not breach of contract. *See Fairfield Ins. v. Stephens Martin Paving, LP*, 246 S.W.3d 653, 687 (Tex. 2008) (Hecht, J., concurring) (stating that "pre-injury waiver of another's liability for gross negligence is against public policy").[29]

In contrast, the risks of reckless, or even intentional, contractual breach are usually economic. And Texas law has long expressed indifference towards grossly negligent breach. In *Jim Walter Homes, Inc. v. Reed*, 711 S.W.2d 617, 618 (Tex. 1986), the Texas Supreme Court refused to enforce punitive damages even though the jury found that the

[29] *Compare Bombardier Aerospace Corp. v. SPEP Aircraft Holdings, LLC*, 572 S.W.3d 213, 230 (Tex. 2019) ("We have also suggested, however, that *pre-injury releases for gross negligence* may be void as a violation of public policy *in the personal injury context*") (emphasis added), *with Zachry*, 449 S.W.3d at 116 (highlighting cases holding that "pre-injury waivers of future liability for gross negligence" are void as against public policy and asserting that "the same may be said of *contract liability*") (emphasis added).

defendant home builder was grossly negligent in its construction. "Gross negligence in the breach of contract will not entitle an injured party to exemplary damages because even an intentional breach will not." *Id*. Afterall, grossly negligent or reckless acts constitute a *lower* state of "culpability than intentional or willful acts." *Id*. Texas is uniquely skeptical of duties of good faith between contracting parties. *English v. Fischer*, 660 S.W.2d 521, 522 (Tex. 1983) (declining to create implied covenant of good faith and fair dealing in every contract because it would subject every contract dispute to "what might seem 'fair and in good faith' [to] each fact finder.").

But that does not resolve the issue. Punitive damages are not contract damages because they are not compensatory; they are damages imposed by law to punish. And even after *Zachry*, the Texas Supreme Court has enforced a punitive damage waiver in the face of proven fraud. *Bombardier Aerospace*, 572 S.W.3d at 219, 234 ("Although Bombardier's conduct in failing to provide SPEP and PE with the new engines they bargained for was reprehensible, the parties bargained to limit punitive damages, and we must hold them to that bargain").[30] Texas law may consistently decide that contracting parties do not get punitive damages, while still not permitting parties to contractually insulate themselves for *really bad* conduct, even for purely economic damages. As the Court noted in *Zachry*, "the law need not impose a duty of good faith on a party to prohibit him from attempting to escape liability for his future, deliberate, wrongful conduct." *Zachry*, 449 S.W.3d at 117.

The authors express no opinion on the overall propriety of subjecting contractual waivers to invalidation on proof of merely reckless or grossly negligent conduct (rather than active, intentional interference). That is a policy question beyond our puny consideration. But we do believe the law should be logically consistent, and a decision like *Zachry*, seemingly at odds with freedom of contract, should be explainable on freedom of contract grounds. We pause to present a brief argument that freedom of contract can *support* limiting the manner that parties contract.

Contracts require *mutual* consent and a meeting of the minds. A bilateral contract that does not bind both parties to some promise is illusory and is treated as no contract at all. *In re 24R, Inc.*, 324 S.W.3d 564, 567 (Tex. 2010) ("When illusory promises are all that support a purported bilateral contract, there is no mutuality of obligation, and therefore, no contract."). Without "[m]utual, reciprocal promises which bind both parties" an agreement

[30] *Bombardier* was a fraud by nondisclosure case. *Bombardier*, 572 S.W.3d at 219. And the Court appeared to be relying on the fact that the plaintiffs wanted to *enforce* the agreement because they did not seek "recission." *Id*. at 232. Had they rescinded and chased traditional out-of-pocket fraud damages the result might have been different. Finally, although the Court held that the defendant breached a fiduciary duty, the plaintiffs did not submit on that theory. *Id*. Again, if the plaintiffs had proceeded on that theory, it remains unresolved whether the Court would enforce the punitive damages waiver.

may be without consideration. *Mendivil v. Zanios Foods, Inc.*, 357 S.W.3d 827, 831 (Tex. App.—El Paso 2012, no pet.). Texas law already does not allow a party to enforce conditions or promises that it frustrates.[31]

Zachry invalidated a damages waiver (not a condition precedent or other promise), but the overall theory holds. Suppose an owner hires a builder to construct a structure on a piece of property for $100. Assume the contract is one-sided; it imposes a strict one-week schedule, places all responsibility for schedule and site access on the contractor, waives any right the contractor has for delays no matter how caused, and imposes liquidated damages in the greatest amount enforceable under Texas law. Pretend the agreement expressly disclaims any duty of good faith, fair dealing, or cooperation, puts all means and methods exclusively on the builder's shoulders, and imposes only one promise on the owner: that it pays the $100 on final completion of the building. All other obligations in the contract belong to the builder. Finally, presume the contract entitles the owner to use the site during construction, gives the owner the right to reject subcontractors unless pre-approved by the owner, and requires the contractor to work around any use of the land by the owner.

On the first day the work is intended to proceed, the builder dutifully shows up to the site prepared to start work. But over the weekend, the pesky owner has hired someone else to construct a moat around the project. When the contractor complains, the owner insists that he wants to relax in his lazy river and watch construction. The contractor attempts to work around the moat by retaining subcontractors experienced in moat-bridge work, but the owner rejects that subcontractor. When the contractor expresses frustration with the owner, the owner tells him to leave the property or face trespassing charges. The contractor goes home promising never to return or deal with that awful owner ever again. Weeks later the contractor is served with a lawsuit; the owner is seeking the cost to complete the work (at a premium, predictably), along with delay damages.

The owner will not, or should not, win the lawsuit. Whether based on illusory contracts, unconscionability, prevention doctrine, or some minimum implied covenant, maybe not of good faith and fair dealing, but at the very least an implied covenant of *not actively interfering with the performance of contract*, no court would enforce this trap masquerading as an agreement. Reasonable minds may disagree about where to draw the line, but most of us instinctively recognize that there must be a minimum standard of

[31] *See, e.g.*, *Clear Lake City Water Auth. v. Friendswood Dev. Co., Ltd.*, 344 S.W.3d 514, 519–20 (Tex. App.—Houston [14th Dist.] 2011, pet. denied) ("Generally, a party who prevents or makes impossible the occurrence of a condition precedent upon which its liability under a contract depends cannot rely on the nonoccurrence to escape liability.") (internal quotations omitted); *Dorsett v. Cross*, 106 S.W.3d 213, 217 (Tex. App.—Houston [1st Dist.] 2003, pet. denied) ("Prevention of performance by one party excuses performance by the other party, both of conditions precedent to performance and of promise").

conduct, even between sophisticated parties, lest the concept of contract breaks down. A jurisdiction that so strictly enforced contracts as to award the owner damages would do enormous damage to private ordering and commerce generally, reducing both to a perverse game of gotcha.

We do not know if *Zachry* is on the right side of that line, but it is beginning to have a broader effect on damages waivers, at least in federal court. The appendix includes cases where courts refused to enforce consequential or other damages waivers based on allegations of recklessness or other conduct. As an example, in *Texas Drain Technologies, Inc. v. Centennial Contractors Enterprises, Inc.*,[32] the defendant invoked "contractual provisions which made . . . delay damages not recoverable" in a motion for summary judgment. *Id*. at *2. The magistrate judge rejected the argument, relying in part on *Zachry* and holding that since sufficient evidence showed that the defendant had "recklessly caused the delays . . . the delay damages provision in the contract" became ineffectual.[33]

Others will follow and we predict eventually Texas state courts will begin refusing to enforce consequential damages clauses on the same grounds that the Texas Supreme Court refused to enforce a no-damages-for-delay clause, including for "gross negligence" as suggested in dicta in *Zachry*. *Zachry*, 449 S.W.3d at 116. It remains to be seen how the Court will address the effect of gross negligence on all contractual limitations and waivers. In the meantime, the argument is there for you and your clients.

We turn now, finally, to consequential damage waivers.

[32] No. H-14-3298, 2017 WL 7688386 (S.D. Tex. 2017).

[33] *Id*. The magistrate judge also held that the damage waiver was unenforceable because the jury found that the defendant caused the first material breach (therefore excusing further performance by the plaintiff), and because the jury awarded damages on the alternative theory of promissory estoppel. *Id*. Respectfully, those arguments make no sense under Texas law. Damage waivers presume that the party asserting them breached; there would be no need to invoke the waiver otherwise. If a first material breach vitiates performance *of a damage waiver*, damage waivers are not enforceable. Yet we know they are. *Bombardier*, 572 S.W.3d at 231 ("Limitation-of-liability clauses, however, are generally valid and enforceable."). And under Texas law, quasi-contract theories like promissory estoppel are unavailable when there is an express contract governing the dispute. *Fortune Prod. Co. v. Conoco, Inc.*, 52 S.W.3d 671, 684 (Tex. 2000) ("Generally speaking, when a valid, express contract covers the subject matter of the parties' dispute, there can be no recovery under a quasi-contract theory"); *Subaru of Am., Inc. v. David McDavid Nissan, Inc.*, 84 S.W.3d 212, 226 (Tex. 2002) ("[T]he promissory-estoppel doctrine presumes no contract exists").

Paradigm (or, creating the monster)

In this section we build limb-by-limb a Frankenstein's monster of a consequential damages waiver. We even engaged in some grave robbery, taking the discarded wastes of consequential damage waivers killed or mutilated by courts or parties. The purpose of this waiver is not to be friendly to any constituency like contractors or owners.[34] We advocate only on behalf of the waiver. Our animating motive is the theory that if sophisticated parties know they want a consequential damages waiver, they deserve to get it good and hard.[35]

Let us start simple. The following is an enforceable consequential damages waiver:

> Neither party shall be liable for special, indirect, incidental or consequential damages.

That is it, that will do. *Reynolds Metals Co. v. Westinghouse Elec. Corp.*, 758 F.2d 1073, 1074 n.1 (5th Cir. 1985). Our job here is done.

On second thought, that will not do—lawyers get paid by the word. And why would we keep it so simple for a complicated topic? If we do not tell the courts what we *meant* by consequential damages they might get it wrong. Let us try one of these three, instead:

> *Consequential Damages*: Notwithstanding any other provisions of this Agreement to the contrary, in no event shall Owner or Contractor be liable to each other for any indirect, special, incidental or consequential loss or damage including, but not limited to, loss of profits or revenue, loss of opportunity or use incurred by either Party to the other, or like items of loss or damage; and each Party hereby releases the other Party therefrom.

Tenn. Gas Pipeline, 2008 WL 3876141 at *3. With the confusing "[n]otwithstanding," the overly formal "in no event," and the redundant "but not limited to," this is beginning to sound like something a lawyer wrote. Or maybe this one:

> LIMITATION OF LIABILITY. IN NO EVENT WILL EITHER PARTY BE LIABLE TO THE OTHER PARTY FOR ANY INDIRECT, INCIDENTAL,

[34] If you are interested in reading from smart lawyers how to modify consequential damage waivers on behalf of specific constituencies, see Robert Bass and John Slates, *Negotiating Tricky Clauses in Prime Contracts—The Sequel*, 32ND ANNUAL CONSTRUCTION LAW CONFERENCE (Feb. 28, 2019) (on file with the Construction Law Section of the State Bar of Texas).

[35] Modified from H.L. Mencken's famous quip about democracy. H.L. Mencken, A LITTLE BOOK IN C MAJOR 17 (1916) ("Democracy is the theory that the common people know what they want, and deserve to get it good and hard.").

> SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING (WITHOUT LIMITATION) LOSS OF PROFIT, INCOME OR SAVINGS, EVEN IF ADVISED OF THE POSSIBILITY THEREOF.

Harper v. Wellbeing Genomics Pty Ltd., No. 03-17-00035-CV, 2018 WL 6318876 at *10 (Tex. App.—Austin 2018, pet. denied) (memo. op.). This one is conspicuous and has a "thereof." Very lawyerly. And one more:

> Neither [party] shall bear any liability to the other for loss of production, loss of profits, loss of business or any other indirect or consequential damages, including, inter-alia, special and punitive damages.

Leahy, 132 S.W.3d at 475. This one has Latin in it, so it must be good. For the torso of our beast, these are not bad starts. All three clauses effectively waive consequential damages. On first blush, it appears the parties intended to specify categories of damages included within the waiver, including lost profits. How did they do? Not so well, as it turns out. Courts held that the first two clauses did not waive the enumerated damages categorically.[36] But the court reached the opposite conclusion for the last clause. *Leahy*, 132 S.W.3d at 475–76 (holding that waiver effectively precluded lost profits whether direct or consequential).

Ostensibly all the parties thought enough of specifically enumerating categories of damages and likely intended to waive them categorically. But only one out of three got what they wanted. We will not dwell on it; this problem is easily enough drafted around. As readers should have guessed by now, the legal rules governing consequential versus direct damages are opaque and unpredictable. Thoughtful construction lawyers should have blunt conversations with their clients about what damages should or should not be included within a consequential damage waiver. Otherwise, their clients will buy a triable issue later. And since the stakes on consequential damages are often large, that dispute can doom settlement prospects, guaranteeing the parties will spend rivers of money getting to a decision.

To fix the problem, we start with the AIA's A201-2017 general conditions, and specifically the consequential damage waiver at § 15.1.7:

[36] *Tenn. Gas Pipeline*, 2008 WL 3876141 at *8 (holding that waiver did not "preclude the recovery of direct damages involving loss of use, opportunity, or profits"); *Harper,* 2018 WL 6318876 at *10 (holding that waiver did "not create a blanket prohibition of damages measured by the loss of profits *unless* those profits are indirect, incidental, special, or consequential").

Waiver of Claims for Consequential Damages
The Contractor and Owner waive Claims against each other for consequential damages arising out of or relating to this Contract. This mutual waiver includes

.1 damages incurred by the Owner for rental expenses, for losses of use, income, profit, financing, business and reputation, and for loss of management or employee productivity or of the services of such persons; and

.2 damages incurred by the Contractor for principal office expenses including the compensation of personnel stationed there, for losses of financing, business and reputation, and for loss of profit, except anticipated profit arising directly from the Work.

This may be good enough. The AIA's use of "includes," however, raises the possibility that a court will treat the listed items in .1 and .2 as merely enumerations of types of consequential damages. To avoid that problem, we recommend adding:

Waiver of Claims for Consequential Damages
The Contractor and Owner waive claims against each other for consequential, incidental, or special damages arising out of or relating to this Contract. The parties also waive the following damages, whether they are consequential, direct, or otherwise:

.1 damages incurred by the Owner for [specific list of waived damages];

.2 damages incurred by the Contractor for [specific list of waived damages].[37]

We added "incidental, or special damages" to this waiver since sometimes Texas cases, especially older cases, use those words to describe consequential damages. The use of "special damages" also puts them directly under Texas Rule of Civil Procedure 56. We removed the AIA's enumerated items because we are agnostic about what damages sophisticated parties should waive; that is their decision to make.[38] We have also made it

[37] The clause is mostly stolen from Allison Snyder, who has a good example of a strong waiver here: https://www.porterhedges.com/assets/htmldocuments/2018.05.15_Snyder_ConsequentialDamagesWhoPaysTheRealPrice.pdf (last accessed by authors on February 7, 2021).

[38] A quick aside. Lawyers refer to this type of clause as a mutual waiver. Consequential damage waivers are never mutual. If someone tells you they want a mutual waiver, they are selling you something. The sort of things that owners want from construction projects, and which can be taken from them because of the other side's breach, are *far* more likely to be consequential damages than what contractors suffer if the owner breaches. We pass no judgment on the propriety of either side

clear in this clause that the categories of damages the parties specifically enumerated are waived no matter what to avoid the *Tenn. Gas Pipeline* and *Harper* problem.

The clause now has good bones and a torso. Let us begin grafting appendages to it.

> **Waiver of Claims for Consequential Damages**
> The Contractor and Owner waive claims against each other for consequential, incidental, or special damages arising out of or relating to this Contract, whether the damages are claimed in contract, tort, or on any other basis. The parties also waive the following damages, whether they are consequential, direct, or otherwise:
> .1 damages incurred by the Owner for [specific list of waived damages];
> .2 damages incurred by the Contractor for [specific list of waived damages].

This is probably unnecessary, since the Texas Supreme Court enforced the punitive (and consequential) damage waiver in *Bombardier* without this language, even though the plaintiffs elected to recover under tort. *Bombardier*, 572 S.W.3d at 217. But why leave anything to chance. Next:

> **Waiver of Claims for Consequential Damages and Covenant Not to Sue**
> The Contractor and Owner waive claims against each other for consequential, incidental, or special damages arising out of or relating to this Contract, whether the damages are claimed in contract, tort, or on any other basis. The parties also waive the following damages, whether they are consequential, direct, or otherwise:
> .1 damages incurred by the Owner for [specific list of waived damages];
> .2 damages incurred by the Contractor for [specific list of waived damages].
> Each party covenants not to sue the other for any damages waived in Section 15.1.7. In the event either party breaches this covenant, it will pay the other's reasonable and necessary attorney's fees in defending against any claims or damages waived above.

Why go to the trouble of waiving the damages if you cannot punish the other side for bringing them up later? In *James Constr. Group, LLC v. Westlake Chemical Corporation*, 594 S.W.3d 722 (Tex. App.—Houston [14th Dist.] 2019, pet. filed), the owner (Westlake) hired James to perform half a billion dollars of construction work at the

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waiving consequential damages, but there is no need for us to pretend that any waiver of legally complicated sets of damages is ever going to be *mutual* to the penny.

owner's chemical plant. *Id*. at 730. They got crossways over the project and sued each other, leading to a verdict in which the jury found that: (1) James breached, (2) Westlake was damaged by the breach by ~$1M, (3) Westlake also incurred ~$3.5M in attorney's fees, but (4) Westlake breached the parties' consequential damage waiver by seeking "chlorine costs" that were consequential, (5) leading to ~$250K in attorney's fees for James in defending against the chlorine costs. *Id*. at 731–32. In its post-verdict judgment, the trial court awarded James another ~$1M on one of its counterclaims (plus the attorney's fees). *Id*. at 732.

On appeal, one issue was whether James could recover attorney's fees due to Westlake's "breach" of the following consequential damage waiver:

> Neither [Westlake] nor [James] shall be liable to the other for any consequential, incidental, indirect or punitive damages of any kind or character, including, but not limited to, loss of use, loss of profit, loss of revenue, loss of productivity, loss of efficiency, or acceleration costs whenever arising under this Contract or as a result of, relating to or in connection with the Work and no claim shall be made by either [Westlake] or [James] against the other for such damages REGARDLESS WHETHER SUCH CLAIM IS BASED OR CLAIMED TO BE BASED ON NEGLIGENCE OR STRICT LIABILITY (INCLUDING SOLE, JOINT, ACTIVE, PASSIVE, CONCURRENT NEGLIGENCE OR GROSS NEGLIGENCE) OR ANY OTHER THEORY OF LEGAL LIABILITY, AND INCLUDING PRE-EXISTING CONDITIONS BUT EXCLUDING GROSS NEGLIGENCE AND WILLFUL MISCONDUCT.

Id. at 762. The parties disputed whether this clause created an express or implied covenant not to sue. *Id*. at 763. The Houston Fourteenth Court of Appeals held it was not a covenant not to sue, treating the "no party 'shall be liable to the other,' and parties shall 'make no claim' or 'no claim shall be made,'" language as mere *waivers*. *Id*. at 765. The court also noted that the provision's heading "Waiver of Consequential Damages" spoke to the parties' limited intent to waive damages. *Id*. Based on that conclusion, the court threw out the $250K attorney fees claim. *Id*. at 766. But it was a close enough question to draw a robust dissent from Chief Justice Frost, who would have treated the "no claim shall be made" as a covenant not to sue, separate from the waiver preceding it. *Id*. at 769 (Frost, C.J., dissenting). Maybe the Texas Supreme Court will decide that "no claim shall be made" can create a covenant not to sue; in the meantime, better not leave it to chance.

Now, your clients have gone to the trouble of specifically enumerating what damages they want, and a remedy if someone fails to honor this clause. The clause has been drafted to specifically align with appellate court holdings. You may be unable to enforce the clause as written at trial, but on appeal you should be in great shape. But what about arbitration?

Waiver of Claims for Consequential Damages and Covenant Not to Sue
The Contractor and Owner waive claims against each other for consequential, incidental, or special damages arising out of or relating to this Contract, whether the damages are claimed in contract, tort, or on any other basis. The parties also waive the following damages, whether they are consequential, direct, or otherwise:

.1 damages incurred by the Owner for [specific list of waived damages];

.2 damages incurred by the Contractor for [specific list of waived damages].

Each party covenants not to sue the other for any damages waived in Section 15.1.7. In the event either party breaches this covenant, it will pay the other's reasonable and necessary attorney's fees in defending against any claims or damages waived above. If binding arbitration is the dispute resolution selected by the parties, the arbitrator has no authority to award damages waived in Section 15.1.7. If the arbitrator awards damages waived in Section 15.1.7, the arbitrator shall have exceeded its authority, and the award may be vacated or modified to conform to this section.

The conventional wisdom is that arbitration awards are difficult to vacate. And under the FAA, parties are generally not free to create judicial review of arbitration awards. *Hall St. Assoc., L.L.C. v. Mattel, Inc.*, 552 U.S. 576, 579, 584 (2008) (interpreting FAA as not permitting judicial review of arbitration award based on parties' agreement that district court could vacate or modify an award if findings of fact were unsubstantiated or conclusions of law were erroneous). But in *Nafta Traders, Inc. v. Quinn*, 339 S.W.3d 84, 97 (Tex. 2011), the Texas Supreme Court held that the TAA permitted parties to contractually agree to judicial review of the award if they tied that review to the arbitrator's authority. There, the agreement to arbitrate stated:

> The arbitrator does not have authority (i) to render a decision which contains a reversible error of state or federal law, or (ii) to apply a cause of action or remedy not expressly provided for under existing state or federal law.

Id. at 88. The Texas Supreme Court distinguished this clause from the one in *Hall Street* ever so slightly because the "limit on the arbitrator's authority" accomplished "directly" what the parties in *Hall Street* tried to accomplish "indirectly." *Id*. at 92. The Texas Supreme Court reiterated its own adoration for freedom of contract and noted that both the TAA and FAA permit vacatur if arbitrators exceed their "powers." *Id*. at 92, 95–96.[39]

[39] *See also* 9 U.S.C. § 10(a)(4) (permitting vacatur "where the arbitrators exceeded their powers"); Tex. Civ. Prac. & Rem. Code § 171.088(a)(3)(A) (mandating vacatur where "arbitrators" "exceeded their power").

Finally, the Texas Supreme Court held that its interpretation of the TAA was not inconsistent with the FAA (both purportedly serving the interest of private ordering), and therefore not preempted. *Nafta*, 339 S.W.3d at 100. SCOTUS denied cert and so the preemption issue remains live. *Quinn v. Nafta Traders, Inc.*, 565 U.S. 963 (2011).

Although *Nafta* was limited to the TAA, federal courts appear ready to vacate awards so long as the arbitrators exceed their powers by "acting 'contrary to express contractual provisions.'" *Soaring Wind Energy, L.L.C. v. Catic USA Incorporated*, 946 F.3d 742, 754 (citing *Beaird Indus., Inc. v. Local 2297, Int'l Union*, 404 F.3d 942, 946 (5th Cir. 2005)). Though they are generally still deferential and must resolve all doubts in favor of the arbitrators' award. *Soaring Wind*, 946 F.3d at 754. Parties *might* get more assurance of judicial review under the TAA, so consider that when selecting which act you arbitrate under.

If you represent a governmental entity, you will not need any of this language to preserve your right to appeal an arbitration award that includes consequential damages for which immunity is not waived. In *San Antonio River Auth. v. Austin Bridge & Road, L.P.*,[40] the Texas Supreme Court recently affirmed (5-4!) that local governmental entities can agree to arbitrate their disputes and that those awards are enforceable, so long as the award is limited to damages for which immunity is waived by the Legislature. *Id*. at 628. But since immunity implicates subject matter jurisdiction, the Court held that immunity waiver was for courts (rather than arbitrators) to decide, even though the AAA's Construction Industry Rules purport to make jurisdiction arbitrable. *Id*. at 626, 628. That is important because it means governmental entities are entitled to judicial review of any award, at least on whether the arbitrators awarded damages for which immunity was not waived. And that argument need not be raised in arbitration; governmental entities can bring it up for the first time on appeal, as subject matter jurisdiction is not waivable.

Let's keep at it and add a neck and head to the monster:

> **Waiver of Claims for Consequential Damages and Covenant Not to Sue**
> The Contractor and Owner waive claims against each other for consequential, incidental, or special damages arising out of or relating to this Contract, whether the damages are claimed in contract, tort, or on any other basis. The parties also waive the following damages, whether they are consequential, direct, or otherwise:
>
> .1 damages incurred by the Owner for [specific list of waived damages];
>
> .2 damages incurred by the Contractor for [specific list of waived damages].

[40] 601 S.W.3d 616, 621–22, 625 (Tex. 2020).

> Each party covenants not to sue the other for any damages waived in Section 15.1.7. In the event either party breaches this covenant, it will pay the other's reasonable and necessary attorney's fees in defending against any claims or damages waived above. If binding arbitration is the dispute resolution selected by the parties, the arbitrator has no authority to award damages waived in Section 15.1.7. If the arbitrator awards damages waived in Section 15.1.7, the arbitrator shall have exceeded its authority, and the award may be vacated or modified to conform to this section.
>
> The waiver and covenant in this section is a separate, independent, and essential term of this agreement and shall be effective even in the event of the failure of any other remedy (including exclusive remedies, if any) in this agreement. The waiver and covenant in this section will survive termination of this agreement or the breach (including material breach) of this agreement by either party. In the event any part of this section is declared invalid, the parties intend for this waiver and covenant to be enforced to the maximum extent permitted by law.

The first sentence in the newest provision serves two goals. First, since everything is negotiable, parties often fight over consequential damage waivers in the context of other waivers or remedies. *See, e.g.*, Robert Bass and John Slates, *Negotiating Tricky Clauses in Prime Contracts—The Sequel*, 32ND ANNUAL CONSTRUCTION LAW CONFERENCE (Feb. 28, 2019) (on file with the Construction Law Section of the State Bar of Texas). For example, an owner or a general contractor may be more willing to waive their own consequential damages if the other party has stipulated to liquidated damages high enough (for the owner) or low enough (for the contractor) to balance the added risk of not recovering consequential damages. But what happens if the liquidated damages remedy (or some other remedy) is tossed out as a penalty or on other public policy grounds? Courts might be tempted to reform other parts of an agreement or opine on whether the waiver and remedy were related and, if so, whether invalidation of one requires invalidation of another to maintain the essential purpose of the agreement. *See, e.g.*, *In re Poly–America*, 262 S.W.3d 337, 360 (Tex. 2008) ("An illegal or unconscionable provision of a contract may generally be severed so long as it does not constitute the essential purpose of the agreement.").

Second, if your clients' agreement is for materials, the clause solves a related problem under Texas's UCC. Section 2.719(b) of the Texas Business and Commerce Code states that where "an exclusive or limited remedy" fails for its "essential purpose" it might be invalidated. But Section 2.719(c) speaks directly to consequential damage waivers, and holds they are enforceable so long as the waiver is not "unconscionable." The "legal quagmire" is whether consequential damage waivers can be invalidated under both (b) and (c), or only (c). *Curtis v. Cerner Corporation*, No. 7:19-cv-00417, 2020 WL 4934950 (S.D. Tex. Aug. 24, 2020) (citing *Caudill Seed & Warehouse Co. v. Prophet 21, Inc.*, 123 F.

Supp. 2d 826, 830 (E.D. Pa. 2000)). As of August 2020, the Southern District of Texas found no Texas or 5th Circuit decisions addressing the issue, but concluded that consequential damage waivers were independent provisions and valid unless unconscionable under (c). *Curtis*, 621 B.R. at 185–86. In support of its conclusion, the court relied on the "relevant contract language" stating that the consequential damage waiver was "independent" and "separate" from an exclusive remedies provision. *Id*. at 182, 185.

This approach is not without danger. If your clients treat consequential damage waivers as independently essential and separate from other remedies, perhaps a court could interpret *other* waivers without this language as being dependent and inessential. If so, you would be stuck having to insert independent and essential carve outs for every waiver your client wants to guarantee enforcement. But that is your problem to decide with your client. We only set out to create an impenetrable monster of a consequential damage waiver.

The remaining survival and reformation provisions can just as easily be moved to a miscellaneous section governing the rest of your contract, but we place them here to emphasize how really very super important this consequential damage waiver is. The authors assumed that it went without saying that any *damage* waiver would survive breach, but we didn't foresee the unusual result in the *Texas Drain Technologies* case discussed above. Better safe than sorry.

Finally, adding a brain so that our fully formed monster can move, maneuver, and be smart:

> **Waiver of Claims for Consequential Damages and Covenant Not to Sue**
> The Contractor and Owner waive claims against each other for consequential, incidental, or special damages arising out of or relating to this Contract, whether the damages are claimed in contract, tort, or on any other basis. The parties also waive the following damages, whether they are consequential, direct, or otherwise:
>
> .1 damages incurred by the Owner for [specific list of waived damages];
>
> .2 damages incurred by the Contractor for [specific list of waived damages].
>
> Each party covenants not to sue the other for any damages waived in Section 15.1.7. In the event either party breaches this covenant, it will pay the other's reasonable and necessary attorney's fees in defending against any claims or damages waived above. If binding arbitration is the dispute resolution selected by the parties, the arbitrator has no authority to award damages waived in Section 15.1.7. If the arbitrator awards damages waived in Section

15.1.7, the arbitrator shall have exceeded its authority, and the award may be vacated or modified to conform to this section.

The waiver and covenant in this section is a separate, independent, and essential term of this agreement and shall be effective even in the event of the failure of any other remedy (including exclusive remedies, if any) in this agreement. The waiver and covenant in this section will survive termination of this agreement or the breach (including material breach) of this agreement by either party. In the event any part of this section is declared invalid, the parties intend for this waiver and covenant to be enforced to the maximum extent permitted by law.

The parties agree that delay damages can be direct or consequential and disagree with footnote 71 in the *Zachry* case because it was wrong.

The importance of this provision should go without saying.

We recognize that this unwieldy clause is unlikely to land in any construction contract. But like Dr. Frankenstein we did not create our monster for good. We created it just to prove that we could! We constructed it piecemeal, and so hopefully the discussion helps and lets readers take what they like and discard the rest. If not, we tried our best.

Denouement **(or, the end, mercifully)**

The appendix contains relevant cases we found over the last four years addressing consequential versus direct damages, waivers, and so on. The authors will happily provide any materials we relied on in either this paper or speech on request. Please email us.

We hope this discussion helps clarify the complicated nature of the problem. Private ordering exists to empower parties to organize their own affairs as they see fit, rather than how some judge, jury, or arbitrator would do so. The purpose of contract law is to bind the parties to the terms they choose. And commercial enterprise depends on this freedom, along with consistency and predictability in application. Yet Consequential damages jurisprudence is neither consistent nor predictable and consequential damage waivers are pervasive. Why? We blame forms and lawyers. Consequential damage waivers are a useful shorthand for limiting potentially colossal risk. But one party's risk mitigation is another's risk assumption. Waived damages do not disappear quietly into the night like a guest who politely retires after briefly overstaying his welcome. They show up later drunk, loud, aggressive, and screaming for attention. They must be faced and dispatched. We owe it to our clients to inform them of the sometimes-unimaginable risks a one paragraph clause can have. And we hope this paper helps, in some small way. Good luck.

APPENDIX

Foreseeability

1. *Bui v. Chandler Co., LLC*, NO. 6:20-CV-00071-ADA-JCM, 2020 WL 3270833 (W.D. Tex. June 17, 2020, no pet.).

(Damages foreseeable at the time of the contract; lost profits)

Bui hired Chandler Companies to repair a roof but then withdrew from/terminated the contract. Bui sued to have the contract declared invalid and Chandler countersued for damages. The appellate court reviewed the trial court's decision on a summary judgment motion for Chandler's claim for lost profits that Chandler would have gotten if Bui hadn't terminated the contract. The issue was whether Bui, a poultry owner, could be expected to know whether Chandler (by being terminated) would lose out on *other* projects. Bui knew Chandler was chasing other work based on conversations between Bui and other poultry owners. The opinion is unfortunately silent as to *when* those conversations happened, so it does not address the timing of foreseeability (at the time of contract or not?). This case adds to the body of caselaw discussing the foreseeability requirement of consequential damages.

2. *Jatex Oil and Gas Exploration L.P. v. Nadel and Gussman Permian, L.L.C.*, No. 11-17-00265-CV, 2020 WL 4873836 (Tex. App. – Eastland Aug. 20, 2020, no pet.)

(Damages foreseeable at the time of contract; foreclosure damages as consequential damages)

Jatex and NGP had a joint operating agreement and NGP charged Jatex for an account to deepen a well. Jatex alleged that the charge was improper and caused Jatex's bank to foreclose on its mineral interests. The primary issue was whether "foreclosure damages" or "value of the mineral interests" that the bank foreclosed on were foreseeable (and therefore recoverable) consequential damages. NGP argued the damages were not foreseeable at the time the parties executed the joint operating agreement. Jatex argued that the damages were industry knowledge and thus foreseeable. The court sided with NGP because there was no evidence that NGP knew *at the time the parties contracted* (1) that Jatex planned to pledge its interest as collateral or (2) about Jatex's other mineral interests.

3. *Int'l Paper Co. v. Signature Indus. Services, LLC*, No. 13-18-00186-CV, 2020 WL 2079145 (Tex. App.—Corpus Christi April 30, 2020, pet. filed)

(Damages foreseeable at the time of the contract)

International Paper Co. (IP) hired Signature Industrial Services LLC (Signature) to build a "slaker" (a large vessel that contains chemicals) at one of its plants. The contract

was for ~$775K but the parties knew the bid was low and planned to use change orders to adjust the price. The jury awarded Signature $2.4M in direct damages and $56M in consequential damages. The contract didn't have a waiver of consequential damages, so the analysis turns on whether the $56M was foreseeable. Signature won on the basis that IP failing to pay contributed to putting Signature out of business, ruined the life of its owner, caused Signature to incur tax liabilities, and forced Signature to lose out on a potential sale of its company. Court of appeals upheld jury finding for consequential damages in part, based on evidence that prior to contract word had spread in the industry about Signature's financial struggles. Court upholds some consequential damages "Because it was foreseeable that not paying invoices to a company who had struggled financially in the year before would cause major financial issues" court upheld $12.4M of the $56M. This case is pending at the Texas Supreme Court.

Categories of damages

4. *Integ Corp. v. Hidalgo Cty. Drainage District No. 1*, No. 13-18-00123-CV, 2019 WL 6205474 (Tex. App.—Corpus Christi Nov. 21, 2019, no pet.) (memo. op.)

(Tex. Local Gov't Code § 262; no waiver consequential damages; attorney's fees damages)

Hidalgo County Drainage District (HCDD) hired Integ Corporation (Integ) as a general "consultant" including as a construction manager. The agreement required HCDD to purchase CGL and E&O insurance policies but they failed to do that. There was a separate investigation into Integ due to conflicts of interest, corruption, and self-dealing, and after the fact HCDD sued Integ. Integ countersued and sought damages for HCDD's failure to procure insurance required under the contract and attorney's fees "incurred defending against" others' claims. The court determined that since the consulting agreement did not require HCDD to defend Integ, Integ's attorney's fees damages were consequential damages and therefore not recoverable because immunity had not been waived for those claims.

5. *Harper v. Wellbeing Genomics Pty Ltd*., NO. 03-07-00025-CV, 2018 WL 6318876 (Tex.App—Austin Dec. 4, 2018, pet. denied) (mem. op.).

(Lost profits as consequential damages; direct versus consequential damages discussion)

Dr. Ruthie Harper filed a patent application that allegedly disclosed Wellbeing's confidential information. PLLG was negotiating a distribution agreement with Qivana, LLC and allegedly misappropriated Wellbeing's intellectual property. Wellbeing sued Harper, Qivana, and a consultant hired by PLLG for trade secret misappropriation, breach of contract, unfair competition, and civil theft under the Texas Theft Liability Act. The parties waived consequential damages including for "loss of profit" and Wellbeing sought profits it didn't get because PLLG cut Wellbeing out of the Qivana deal. The court held that the lost profits were consequential, since they were profits Wellbeing didn't get from

a separate deal PLLG got from breaching the nondisclosure agreement. Wellbeing could not recover the profits because it waived consequential damages.

Immunity

6. *Amador v. City of Irving*, No. 05-19-00278-CV, 2020 WL 1316921 (Tex. App.—Dallas March 20, 2020, no pet.) (memo. op.)

(Tex. Local Gov't Code § 271.153; direct damages)

Tripartite agreements between the City, Amador, and a residential repair contractor. The City-Amador contract required the City to "ensure that all work is completed at the highest quality level and most workmanlike manner possible." The City recommended a repair contractor to Amador. Amador contended her house was worse off after the contractor performed repairs due to unlevel floors, heaving floors, walls, doors, and cracking. The court cited Zachry, saying "Direct damages for breach…Certainly qualify [for balance due and owing]." This case bolsters previous holdings that costs to repair deficient work is a direct damage, at least where breaching party agrees work will be performed in a "workmanlike manner".

7. *Ct.y of Galveston v. Triple B Services, LLP*, 498 S.W.3d 176 (Tex. App.—Houston [1st Dist.] 2016, pet. denied).

(Tex. Local Gov't Code § 262; sovereign immunity; delay versus disruption damages)

The county hired Triple B to build a stretch of road. The county delayed moving certain utility lines, which caused Triple B to incur "disruption damages" and some lost profits. The Court held that some of Triple B's pleaded damages were consequential ("lost profits, which are a typical example of a non-direct, consequential damage and, thus, are not a cost incurred by Triple B as a direct result of the County's delay."). Also held that some of Triple B's damages were direct, at least as pleaded.

8. *Dallas/Fort Worth Int'l Airport Bd. v. Vizant Technologies, LLC*, 576 S.W.3d 362 (Tex. 2019).

(Tex. Local Gov't Code § 271.153; payment processing costs consequential damages; delay damages under immunity statute)

DFW hired Vizant on a not-to-exceed $50K formulaic fee with a "good faith effort" promise to pay more if Vizant exceeded the amount. Vizant hit $50K and DFW terminated the contract, rejecting staff recommendations to pay more to Vizant. Vizant sought $330K based on a formulaic fee for processing payment costs. A lot of this decision hinges on whether a promise to "in good faith" reup a contract, with no guarantee, imposes an obligation at all. The Texas Supreme Court hasn't resolved this issue before and didn't

resolve it in this case. The Court assumed it was a real promise but denied Vizant's damages on alternative grounds, namely that the $330K was consequential and therefore not waived by the immunity statute. The Court noted that even if DFW had made a good faith effort, it still could have refused to approve the $330K fee, so that amount could not possible have been a natural, necessary, and direct result of DFW's breach.

9. *El Paso Educ. Initiative, Inc. v. Amex Properties, LLC*, 564 S.W.3d 228 (Tex. App.—El Paso 2018, *rev'd on other grounds* at 602 S.W.3d 521).

(Tex. Local Gov't Code § 271.153; plea to the jurisdiction)

Amex Properties sued El Paso Education Initiative (EPEI) claiming that EOEI anticipatorily breached its lease and sought actual damages, consequential damages, and attorney's fees. EPEI wanted to rent from Amex and proposed a building on Amex's land, but then backed out of the lease. The lease required EPEI to pay directly to Amex's contractor some of the construction costs and to reimburse Amex for the costs to cure EOEI's breach. The court held that some of the damages like invoices for construction costs (which Amex had paid to a builder to construct the building EPEI wanted to lease) were direct damages, at least for the purposes of a plea to the jurisdiction. It is hard to tell how much of their analysis is the difference between "balance due and owed" versus not balance due and owed, or direct versus consequential. The court did say there was a fact issue as to whether certain construction costs were "direct or consequential".

10. *La Joya Indep. Sch. Dist. v. Trevino*, No. 13-17-00333-CV, 2019 WL 1487358 (Tex. App.—Corpus Christi April 4, 2019, pet dism'd) (memo. op.)

(Tex. Local Gov't Code § 271.153; lost profits)

La Joya ISD hired Trevino as an insurance consultant and La Joya had the right to terminate the contract "for good cause." La Joya terminated the contract, and Trevino alleged wrongful termination and sought "fees and commissions he would have earned for future services rendered" if he had not been terminated. Trevino argued these damages were direct damages because he was entitled to the profits under the contract. The court held that the damages Trevino sought "constitute lost profits which are consequential damages." Court based its decision primarily on *Tooke* as the profits Trevino sought were for work he did not perform (since he had been terminated).

11. *N. Texas Mun. Water Dist. v. Jinright*, No. 05-18-00152, 2018 WL 6187632 (Tex. App.—Dallas Nov. 27, 2018, pet. denied).

(Tex. Local Gov't Code § 271.153; damage to property as consequential damages)

The water district bought a pipeline easement from several landowners, who intended to build homes on the land the easement was on. The landowners claimed that the

district damaged their fences, trees, and turned "lush green area" into "weedborne and barren" land. The landowners sought the cost to restore the land and the delays it caused to constructing houses on the property. The court said the breach here did not have the "required nexus" to the damages for the damages to be direct. This case is important as a counterbalance to any assumption that damage to property is by definition direct damages. But it is not clear that any property owned by the plaintiffs was damaged--there was some fencing damaged but the governmental entity fixed that. The "required nexus" language is idiosyncratic. It does not appear in any other consequential damage case that we are aware of, and the case the court cited, *Basic Capital Mgmt., Inc. v. Dynex Commercial, Inc*., does not use that language. The damages the court called consequential also included damages for delay related to one of the homeowner's personal home construction.

Post-*Zachry*

12. *Armstrong v. Curves Internat'l, Inc*., No. 6:15-cv-294-RP, 2017 WL 894437 (W.D. Tex. March 6, 0217).

(Refusing to enforce assignment provision in contract)

The court in this case refused to enforce an assignment of claims (with waivers) on the basis that allegations of "recklessness, or gross negligence" precluded waiver under the dictum in Zachry. The court considered the assignment provision in the franchise agreement to be "astoundingly broad" and therefore void against public policy.

13. *Bombardier Aerospace Corp. v. STEP Aircraft Holdings, LLC*, 572 S.W.3d 213 (Tex. 2019).

(Punitive damages waiver enforced in the face of fraud by non-disclosure)

The court upheld a fraud by non-disclosure finding against the defendant, but enforced a punitive damages waiver. The plaintiff was trying to enforce the contract rather than just seeking out-of-pocket expenses, and the Texas Supreme Court treated the "damages-limitation" as a "limited warranty that is the basis of the bargain." The Court declined to say if it would have enforced the punitive damage waiver if the plaintiff secured a breach of fiduciary duty claim, or sought non-contractual damages.

14. *Tex. Drain Tech., Inc. v. Centennial Contractors Enterprises, Inc*., No. H-14-3298, 2017 WL 7688386 (S.D. Tex. Nov. 1, 2017).

(Recklessly caused delays; prior material breach)

The jury here awarded breach of contract and promissory estoppel/unjust enrichment damages after the jury found both parties breached the contract. The court upheld delay damages on three bases (1) evidence could support "recklessly caused" delays

(citing *Zachry*) rendering the delay damage waiver unenforceable; (2) evidence supported prior material breach finding; and (3) evidence supported alternative ground of promissory estoppel/unjust enrichment recovery.

15. *Matter of Dallas Roadster*, 846 F.3d 112 (5th Cir. 2017)

(Refusing to enforce waiver of consequential damages in summary judgment proceeding)

This decision is procedurally complicated; several of the orders invalidating damage waivers were made at the trial court, specifically at 2015 WL 12911345. It involves many serious allegations against the party that waived consequential damages, and some minor allegations against the bank for allegedly bad faith acceleration of a note. A magistrate judge initially enforced the consequential damages waiver before a new judge reversed that decision and upheld the damages for trial. Eventually, the Fifth Circuit reversed this case on other grounds, finding that the bank had not breached at all, and so *Zachry* was inapplicable. The court held that *Zachry* does not apply to the loan provisions that allowed recovery of the bank's attorney's fees. "In *Zachry*, the unenforceable provision would have allowed the owner to insulate itself from liability for its own deliberate and wrongful interference, and the Texas Supreme Court emphasized the policy justification for not allowing a party to escape liability for deliberate and wrongful actions…But in this case, TCB is not using the loan provisions to shield itself from liability because it would not otherwise be facing any liability—TCB successfully defeated the counterclaims."

Miscellaneous

16. *AES Valves, LLC v. Kobi Internat'l, Inc*., No. 01-18-00081-CV, 2020 WL 1880781 (Tex.App.—Houston [1st Dist.] April 16, 2020, no pet.).

(Pleading special damages Tex. R. Civ. Proc. 56; default judgment proceeding)

The court overruled a $4.5M award for consequential damages due to a failure to specifically plead consequential damages. It was a default judgment case, so likely that the defendant failed to specially except to anything, ignoring TRCP 90.

17. *Curtis v. Cerner Corp*., No. 7:19-cv-00417, 2020 WL 4934950 (S.D. Tex. Aug. 24, 2020).

(UCC limitations on remedies; consequential damages in Tex. Bus. & Comm. Code § 2.719(b))

This case addresses the two provisions in the Texas Business and Commerce Code that apply to contractual limitations on remedies: (1) parties can limit or substitute UCC remedies but only if the substitution does not "cause an exclusive or limited remedy to fail of its essential purpose" (2.719(b); and (2) consequential damages can be limited unless

doing so would be unconscionable (2.719(c)). The technical issue before the court was whether Section 2.719 prohibits consequential damages waivers that fall under both 2.719(b) and 2.719(c). The court held that only (c) applied, especially since the agreement itself treated the consequential damages as an independent, essential term.

18. *James Constr. Group LLC v. Westlake Chemical Corp*., 594 S.W.3d 722 (Tex.App.—[14th Dist.] Dec. 17, 2019, pet. filed).

(Covenant not to sue in consequential damages waiver)

In this case, the parties' agreement had a mutual waiver of consequential damages that also said "no claim shall be made by either [owner] or [contractor] against the other for [consequential damages]." The contractor alleged this was a covenant not to sue, and the jury awarded attorney's fees to the contractor for defending against the owner's consequential damages claims. The court held that the waiver was just a waiver, not a covenant not to sue. This case is pending before the Texas Supreme Court.

19. *Nelson v. Vernco Constr., Inc.*, 566 S.W.3d 716 (Tex. App.—El Paso 2018, pet. denied, judgm't set aside)

(Pleading special damages Tex. R. Civ. Proc. 56; waiver Tex. R. Civ. Proc. 90)

Plaintiff won $350K in consequential damages. Defendant challenged the award under TRCP 56. Plaintiff claimed TRCP 56 was waived for failing to raise it in a special exception and the court agreed even though the defendant orally objected to the inclusion of consequential damages in the jury charge conference.

20. *San Antonio River Auth. v. Austin Bridge & Road, L.P.*, 601 S.W.3d 616 (Tex. 2020).

(Tex. Local Gov't Code § 271; arbitrator authority)

The San Antonio River Authority contracted with Austin Bridge & Road to perform repairs to the Medina Lake Dam. Construction costs went over budget, and the construction contract required arbitrating disputes. The arbitrator denied the River Authority's plea of governmental immunity so the River Authority objected to continuing arbitration and instead filed suit against Austin Bridge & Road in district court. The Texas Supreme Court concluded that Tex. Local Gov't code Chapter 271 authorizes local governments like the River Authority to agree to arbitrate claims brought under the chapter (for construction contracts). It also held that immunity waiver must be decided by courts (rather than arbitrators), but on these facts the governmental entity's immunity had been waived, at least in part.

21. *Soaring Wind Energy LLC v. Catic USA Inc*., 946 F.3d 742 (5th Cir. Jan. 7, 2020).

(Limiting arbitrator authority regarding awarding damages)

Arbitration agreement said arbitrators had no "authority to award special, exemplary, punitive, or consequential damages." The Fifth Circuit agreed that it could reverse if arbitrators exceeded their authority, but disagreed that that happened in this case. This is more of a punitive damages case than consequential damages case but informs drafting consequential damages waivers for arbitration.