



CONSTRUCTION LAW ALERT

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The “Economic Waste” Doctrine in Construction Cases

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It is important for construction participants, including owners and contractors, to understand the “economic waste” doctrine and its effect on the recovery of damages in construction lawsuits. Under the doctrine of “economic waste,” a court is not likely to require a contractor to spend exorbitant amounts of money to fix a minor instance of non-conformity with the specifications.

Thus, when defects in a completed structure cannot be physically remedied without tearing down and rebuilding at a cost that would be imprudent and unreasonable, the law does not require damages to be measured by a method requiring economic waste (e.g., the payment of damages to remove and replace the nonconformity).

Consider the following scenario: Owners contract with a general contractor for the construction of a home for \$1 million. After the owners fail to make a final payment due under the construction contract, the contractor sues. The owners counterclaim alleging that the home was built at an elevation of 7.5 feet instead of the contracted-for 8.5 feet. The owners assert that they are entitled to recover the cost to tear down the home and to rebuild it at the correct elevation – \$930,000 according

to their civil engineer. The contractor, on the other hand, asserts that the cost to cure the elevation defect is unreasonable and the proper measure of damages is the diminution in the value of the home as a result of the lower elevation – \$25,000. The court applies the economic waste doctrine and the owners are awarded \$25,000 in damages for the elevation defect.

Consider another example involving the application of the economic waste doctrine. A contractor agrees to use a certain brand of building material and uses an equally good or equivalent brand. To replace the building material with the specific brand building material required in the contract would be clearly disproportionate to the decrease in value of the home. The owner is only entitled to nominal damages.

The “Economic Waste” Doctrine

The usual measure of damages for the defective construction of a building due to breach of contract or negligence includes, in addition to other items of damages which may be proved, the reasonable cost of repair and completion of the building in accordance with the original contract design. There is an

exception to this rule, however, if the cost necessary to repair or replace the defective construction is grossly disproportionate to the results to be obtained and the building is not required to be required to be repaired as a result of an unsafe condition. This is known as the “economic waste” doctrine. In such a case, the amount of damages is the difference between the value of the building contracted for and the value of the defective building actually received.

There is no mathematical formula to determine whether the doctrine of economic waste applies. Some courts applying the doctrine of economic waste have analyzed the relationship between the cost of remedial work and the cost or value of the structure to determine whether remedial work constitutes economic waste. Generally, as the materiality of the construction defect or deficiency increases, courts are more likely to order repair/replacement despite substantial disparities between the cost of repair/replacement and the diminution in value.

Use of Expert Testimony

Expert witnesses, including engineers, architects, contractors, and financial and appraisal experts, play a critical

role in construction cases involving the economic waste doctrine. For example, experts can be used by contractors to show that nonconforming materials can function and perform within appropriate design or safety factors, that a certain remedial procedure is suitable, to establish the amount of the diminution in value of the structure resulting from the alleged defect (which is less than the cost to remove and replace the nonconformity). Owners can use experts to establish the existence of defects or deficiencies, that the appropriate remedy is to remove and replace the nonconforming material or work, and to show the amount to remove and replace the nonconformity.

“Contracting Away” the Economic Waste Doctrine

Many standard construction contracts contain language which a party can argue reflects an agreement to a cost to repair measure of damages, thereby precluding the application of the economic waste doctrine. For example, standard form construction contracts typically may language that provides that:

“[t]he Contractor shall promptly correct Work . . . failing to conform to the requirements of the Contract Documents, whether observed before or after Substantial Completion, and whether or not fabricated, installed or completed” and that “[t]he Contractor shall bear costs of correcting such rejected Work”

One Florida court held that such a provision in a construction contract was not intended to address a situation where to effect a correction, an entire completed home would need to be torn down and rebuilt at a cost exceeding the total contract price. The court, however, suggested that a more explicit and specific provision could be used to contract away the application of the economic waste doctrine. Parties should be aware of the option and effect of including an explicit and specific provision that contracts away the economic waste doctrine.

Conclusion

Contractors and owners should understand the economic waste doctrine, the factual scenarios

under which courts will apply the doctrine, and how the doctrine can affect damages for breach of contract or noncompliance. Under the economic waste doctrine, contractors can avoid substantial costs to repair or replace defective construction when the costs are grossly disproportionate to the results to be obtained, and owners are compensated for any decrease in value of the structure, property or work. ■

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