IN THE SUPREME COURT OF THE STATE OF NEVADA

RWR DEVELOPMENT OF NEVADA, LLC, A NEVADA LIMITED LIABILITY COMPANY; AND R. WILLIAM RHEINSCHILD, AN INDIVIDUAL,
Appellants,
vs.
MARK ANDERSON AND KATHLEEN K. ANDERSON,
Respondents.

No. 43353

FILED

APR 19 2006

JANETTE M. BLOOM
CLERK OF SUPREME COURT
BY
CHIEF DEPUTY CLERK

ORDER AFFIRMING IN PART, REVERSING IN PART AND REMANDING

This is an appeal from a district court judgment in a construction contract action. Second Judicial District Court, Washoe County; Janet J. Berry, Judge.

Respondents Mark and Kathleen Anderson entered into a contract with SierraSage to build a custom home. The parties later executed a contract addendum increasing the contract price and agreeing that the price could increase or decrease based on the date escrow closed. In addition, the Andersons executed an agreement with Reserve Collection, whereby Reserve agreed to indemnify the Andersons for any costs incurred to remove liens executed against their home. Due to SierraSage's failure to pay subcontractors, the Andersons terminated the parties' contract and hired another contractor to finish the house.

At the behest of the Nevada State Contractors Board, appellant R. William Rheinschild, president of appellant RWR Development of Nevada (RWR), signed a personal indemnification agreement (PIA) on behalf of SierraSage. Rheinschild executed the PIA to allow SierraSage to maintain its contractor's license. Rheinschild agreed

to indemnify SierraSage's creditors against any loss or damages the creditors "may suffer" because of SierraSage's failure to pay obligations incurred "in the ordinary course of construction business."

The Andersons sued SierraSage, Rheinschild, and RWR for breach of contract. The district court determined that Rheinschild was liable to the Andersons under the PIA and that all defendants were jointly and severally liable to the Andersons.

Rheinschild and RWR appeal, raising numerous points of error. We conclude that the district court properly determined Rheinschild and RWR were liable but awarded excessive damages to the Andersons.

Indemnification Agreement

Rheinschild's primary argument is that the district court erred in concluding the indemnification agreement covered the Andersons' breach of contact claim. He argues the agreement's use of the words "may suffer" indicate it only covered future losses and that the Andersons' injuries were not incurred "in the ordinary course of business."

Because Rheinschild was a compensated guarantor, the PIA must be construed liberally in the Andersons' favor.[1] This situation is analogous to Lum v. Lee Way Motor Freight, Inc., where the Oklahoma Supreme Court concluded a continuing guaranty by PepsiCo of its subsidiary's obligations applied to the subsidiary's preexisting debts.[2] While the guaranty in Lum "was actuated by PepsiCo's 'personal interest'

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[1]See Zuni Constr. Co. v. Great Am. Ins. Co., 86 Nev. 364, 367, 468 P.2d 980, 982 (1970).

[2]757 P.2d 810, 816 (Okla. 1987).

in preserving [its subsidiary's] self-insured status," the PIA at issue here was executed to ensure SierraSage's obligations could be met and to help the company keep its contractor's license.[3] Although Rheinschild asserts the use of the past tense in the Lum guaranty distinguishes it from the PIA, the Lum court never indicated the guaranty's language was a deciding factor in its decision. Instead, the court concluded that PepsiCo was a compensated guarantor and, as a result, the guaranty must be construed against it.

When the PIA is construed against Rheinschild, it must be held to cover the Andersons' claims. The PIA's use of the words "may suffer" does not alter our analysis.[4] Neither does the PIA's reference to obligations incurred "in the ordinary course of business." SierraSage's business includes the execution of real estate contracts. If the execution of these contracts is covered by the PIA, it is appropriate that SierraSage's subsequent breach of these contracts be covered. Even if a breach is atypical, it is a foreseeable result of contract formation.

As a result, the district court's conclusion that the PIA applied to the Andersons' claim was proper.

Joint Liability

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[3]Id.; see Restatement (Third) of Suretyship and Guaranty §14 cmt. c (1996) (providing that a compensated surety includes any individual receiving a direct benefit from the suretyship).

[4]Further undercutting Rheinschild's claim that the agreement did not cover pre-existing obligations, the PIA states its acceptance by SierraSage's current creditors was waived. Certainly any creditors SierraSage had at the time of the PIA's execution would have preexisting debt owed to them.

Rheinschild and RWR also argue that the district court improperly held them liable for SierraSage's breach of contract and Reserve's breach of the agreement to indemnify the Andersons for costs incurred to remove any mechanic's liens recorded against the Andersons' property. This argument lacks merit.

The record is replete with evidence supporting the district court's conclusion that Rheinschild, RWR, Reserve, and SierraSage were jointly liable for the Andersons' losses. Evidence at trial indicated RWR, Reserve, Rheinschild, and SierraSage diverted funds from one entity to the other, were undercapitalized, and failed to follow LLC formalities. SierraSage's president admitted that SierraSage was not paying its subcontractors due to insufficient funds. He also admitted that the money paid to SierraSage from the Andersons' construction loan went into a bank account for Reserve. Further, Rheinschild stated that he had control and an ownership interest in RWR, SierraSage and Reserve and that it was the practice of all three entities to use the assets of the other entities to pay expenses. The use of the limited liability structure cannot be used to evade legal obligations and defeat public policy.[5] As a result, substantial evidence supported the district court's conclusion that all defendants were jointly liable to the Andersons.

Damages for contract addendum

Rheinschild also argues that the district court's award of $108,000 in damages based on the contract addendum was improper. The addendum provided for an increase or deduction in the contract price based on the date escrow closed. Specifically, if escrow closed after August

[5]See Jory v. Bennight, 91 Nev. 763, 766, 542 P.2d 1400, 1403 (1975).

10, 2001, the contract amount would decrease by $1,000 for each week until escrow closed.

Rheinschild initially argues this addendum was intended to penalize SierraSage for nonperformance of the contract and such penalty clauses are unenforceable as a matter of law.[6] However, liquidated damages are recoverable for breach of contract so long as the amount is "arrived at by a good faith effort to estimate the actual damages that will probably ensue from a breach."[7] Mr. Anderson's testimony indicated the addendum was an appropriate liquidated damages provision. He testified that adjusting the contract price upward was intended to estimate the extra costs SierraSage would incur to complete the project before the contract date. Similarly, the provision decreasing the contract price was intended to estimate the Andersons' damages if SierraSage failed to complete the home by August 10, 2001. Mr. Anderson's reference to the $1,000 deductions as a penalty when drafting the addendum does not render it void.[8]

However, the district court erred in awarding the Andersons $1,000 per week until September 9, 2003, the date the final lien against the Andersons' home was released. Because the addendum was intended

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[6]Mason v. Fakhimi, 109 Nev. 1153, 1156, 865 P.2d 333, 335 (1993).

[7]Id.

[8]T.R. Inc. of Ashland v. Brandon, 87 P.3d 331, 335-36 (Kan. Ct. App. 2004) ("'Greater latitude is allowed in construing an instrument which is prepared by a draftsman who is a layman, or unskilled, than in a case in which the instrument is prepared by a skillful draftsman.'" [Citation omitted] (quoting Springer v. Litsey, 345 P.2d 669, 673 (Kan. 1959) (alteration in original))).

as a reasonable estimate of the Andersons' damages for not being able to move into their home, their damages should have stopped accruing on April 24, 2002—the date they were granted a temporary certificate of occupancy and began living in the home. Although additional work on the home occurred after this date, these additional costs of completion were not the type of damages for which the $1,000 provision was intended to compensate. As a result, the district court should have only awarded $37,000 based on the contract addendum, reflecting the 37 weeks between the contract's date of completion and the date the Andersons were able to move into their home.

Cost of completion damages

Rheinschild also argues that the district court awarded excessive cost-of-completion damages. We agree. The measure of damages for a contractor's breach of contract is the difference between the contract price and the actual cost of completing construction.[9] Assessing damages based on the actual cost incurred "places 'the nonbreaching party in the same position it would have been in by full performance.'"[10]

The Andersons claimed to have spent $471,529 in actual construction costs to build the house and an additional $76,361 in overhead costs incurred after SierraSage's breach. Although the evidence supports all of the Andersons' actual construction costs, we conclude the evidence only supports a maximum of $28,765 in overhead costs.

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[9]Kirkpatrick v. Temme, 98 Nev. 523, 525-26, 654 P.2d 1011, 1013 (1982).

[10]Id. at 526 (quoting Marcou Const. Co. v. Tinkham Indus. & Dev. Corp., 371 A.2d 1187, 1188 (N.H. 1977)).

The Andersons' split their overhead costs into two categories: (1) $66,361 in administrative and overhead costs purportedly performed by the Andersons after the contract with SierraSage was terminated; and (2) $10,000 in administrative and overhead costs for line items left unperformed by SierraSage. Each category is discussed in turn.

First, we conclude that substantial evidence supports most of the items included in the Andersons' $66,361 request. Mr. Anderson testified that, because the contract was approximately half performed at the time it was terminated, additional overhead costs were incurred. These costs were estimated at approximately 50 percent of the line item costs included in the original contract. Mr. Anderson calculated these costs in a reasonable fashion by using the values from the parties' original contract as a basis for calculating additional overhead damages resulting from SierraSage's breach. Neither SierraSage nor Rheinschild introduced evidence demonstrating that Mr. Andersons' calculations were erroneous.

No evidence, however, supports the Andersons' request of $37,596 for overhead and profit. In the parties' original contract, this figure represented the amount SierraSage would be paid as overhead and profit. No evidence indicates the Andersons actually incurred this additional cost due to SierraSage's breach. In fact, Mr. Anderson acknowledged this item was included because he believed the original contract amount should be reduced by this amount due to SierraSage's failure to complete the contract. Because no evidence indicates the Andersons actually suffered this loss, it should be deducted from the district court's award of $66,361 for overhead costs.

Similarly, we conclude that no evidence supports any portion of the district court's award of the $10,000 sought as overhead costs left

unperformed by SierraSage. On cross-examination, Mr. Anderson acknowledged that these items were not additional expenses that resulted from SierraSage's breach, but instead believed the contract amount should be reduced because these items were never performed. These are improper damages for a breach of contract action.[11]

In conclusion, the maximum overhead expenses supported by the record are $28,765. Adding this amount to the $471,529 in actual construction costs, the maximum cost of completion supported by the evidence is $500,294.

Interest damages

In his opening brief, Rheinschild argued that the district court erred in awarding the Andersons $19,136 to compensate for interest paid to their construction lender because of SierraSage's excessive draws from their construction loan account. In their answering brief, the Andersons' presented no support for this award, instead focusing on the appropriateness of the other two interest awards not at issue on appeal. We note that we may treat the Andersons' failure to respond to Rheinschild's argument as a concession that the $19,136 was improperly awarded.[12]

Even considering the award's merits, we conclude the $19,136 is not supported by substantial evidence. At oral argument, the Andersons' counsel argued this award was based on SierraSage being unjustly enriched by having use of the Andersons' funds. However,

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[11]See id.

[12]Badillo v. American Brands, Inc., 117 Nev. 34, 42, 16 P.3d 435, 440 (2001); see Trammell v. State, 622 So.2d 1257, 1261 (Miss. 1993).

counsel was unable to explain how the Andersons were harmed when they would have had to pay this amount even if SierraSage had finished the project. Thus, the damages were not a result of SierraSage's breach and not recoverable. As a result, we conclude the district court's $19,136 award was erroneous.

Conclusion

For the foregoing reasons, we conclude that the district court did not err in imposing liability on Rheinschild and RWR. We further conclude, however, that the district court's award of damages to the Andersons was excessive. Accordingly, we

ORDER the judgment of the district court AFFIRMED IN PART AND REVERSED IN PART AND REMAND this matter to the district court for proceedings consistent with this order.

Douglas, J.
Douglas

Becker, J.
Becker

Parraguirre, J.
Parraguirre

cc: Hon. Janet J. Berry, District Judge
Horvitz & Levy, LLP
Mark H. Gunderson, Ltd.
Erwin & Thompson
Washoe District Court Clerk