

Calculating Expectation Damages

The following cases introduce a complication when calculating expectation damages. A difficulty arises because there are at least two ways to think about how to get an aggrieved party to the place they would have been had the contract been performed: we can either use a baseline of the cost of performance or we can evaluate the aggrieved party's losses by market value differentials between where the party is and where they would have been had the contract been performed. In some cases, the cost of performing the contract is high, but the diminution of market value of the good or property if the contract is not performed is much lower. Some courts have concluded that if the disparity between the two measures is too great, it will be wasteful to order cost of completion, or that doing so will result in a windfall to the promisee. Consider whether the courts in the following cases reach the right result in assessing these two damage measures. Also consider whether the cases are distinguishable from one another – i.e., whether different facts in the cases compel different results.

Jacob & Youngs, Inc. v. Kent

230 N.Y. 230 (N.Y. Court of Appeals 1921)

CARDOZO, Judge:

The plaintiff built a country residence for the defendant at a cost of upwards of \$77,000, and now sues to recover a balance of \$3,483.46, remaining unpaid. The work of construction ceased in June, 1914, and the defendant then began to occupy the dwelling. There was no complaint of defective performance until March, 1915. One of the specifications for the plumbing work provides that 'all wrought iron pipe must be well galvanized, lap welded pipe of the grade known as 'standard pipe' of Reading manufacture. The defendant learned in March, 1915, that some of the pipe, instead of being made in Reading, was the product of other factories. The plaintiff was accordingly directed by the architect to do the work anew. The plumbing was then encased within the walls except in a few places where it had to be exposed. Obedience to the order meant more than the substitution of other pipe. It meant the demolition at great expense of substantial parts of the completed structure. The plaintiff left the work untouched, and asked for a certificate that the final payment was due. Refusal of the certificate was followed by this suit.

The evidence sustains a finding that the omission of the prescribed brand of pipe was neither fraudulent nor willful. It was the result of the oversight and inattention of the plaintiff's subcontractor. Reading pipe is distinguished from Cohoes pipe and other brands only by the name of the manufacturer stamped upon it at intervals of between six and seven feet. Even

the defendant's architect, though he inspected the pipe upon arrival, failed to notice the discrepancy. The plaintiff tried to show that the brands installed, though made by other manufacturers, were the same in quality, in appearance, in market value and in cost as the brand stated in the contract--that they were, indeed, the same thing, though manufactured in another place. The evidence was excluded, and a verdict directed for the defendant. The Appellate Division reversed, and granted a new trial.

We think the evidence, if admitted, would have supplied some basis for the inference that the defect was insignificant in its relation to the project. The courts never say that one who makes a contract fills the measure of his duty by less than full performance. They do say, however, that an omission, both trivial and innocent, will sometimes be atoned for by allowance of the resulting damage, and will not always be the breach of a condition to be followed by a forfeiture (*Spence v. Ham*, 163 N. Y. 220; *Woodward v. Fuller*, 80 N. Y. 312; *Glacius v. Black*, 67 N. Y. 563, 566; *Bowen v. Kimbell*, 203 Mass. 364, 370)....

* * *

[T]he law will be slow to impute the purpose, in the silence of the parties, where the significance of the default is grievously out of proportion to the oppression of the forfeiture. The willful transgressor must accept the penalty of his transgression (*Schultze v. Goodstein*, 180 N. Y. 248, 251; *Desmond-Dunne Co. v. Friedman-Doscher Co.*, 162 N. Y. 486, 490). For him there is no occasion to mitigate the rigor of implied conditions. The transgressor whose default is unintentional and trivial may hope for mercy if he will offer atonement for his wrong (*Spence v. Ham*, *supra*).

In the circumstances of this case, we think the measure of the allowance is not the cost of replacement, which would be great, but the difference in value, which would be either nominal or nothing. Some of the exposed sections might perhaps have been replaced at moderate expense. The defendant did not limit his demand to them, but treated the plumbing as a unit to be corrected from cellar to roof. In point of fact, the plaintiff never reached the stage at which evidence of the extent of the allowance became necessary. The trial court had excluded evidence that the defect was unsubstantial, and in view of that ruling there was no occasion for the plaintiff to go farther with an offer of proof. We think, however, that the offer, if it had been made, would not of necessity have been defective because directed to difference in value. It is true that in most cases the cost of replacement is the measure (*Spence v. Ham*, *supra*). The owner is entitled to the money which will permit him to complete, unless the cost of completion is grossly and unfairly out of proportion to the good to be attained. When that is true, the measure is the difference in value. Specifications call, let us say, for a foundation built

of granite quarried in Vermont. On the completion of the building, the owner learns that through the blunder of a subcontractor part of the foundation has been built of granite of the same quality quarried in New Hampshire. The measure of allowance is not the cost of reconstruction....

The order should be affirmed, and judgment absolute directed in favor of the plaintiff upon the stipulation, with costs in all courts.

McLAUGHLIN, Judge, dissenting:

* * *

I am of the opinion the trial court was right in directing a verdict for the defendant. The plaintiff agreed that all the pipe used should be of the Reading Manufacturing Company. Only about two-fifths of it, so far as appears, was of that kind. If more were used, then the burden of proving that fact was upon the plaintiff, which it could easily have done, since it knew where the pipe was obtained. The question of substantial performance of a contract of the character of the one under consideration depends in no small degree upon the good faith of the contractor. If the plaintiff had intended to, and had complied with the terms of the contract except as to minor omissions, due to inadvertence, then he might be allowed to recover the contract price, less the amount necessary to fully compensate the defendant for damages caused by such omissions. (*Woodward v. Fuller*, 80 N. Y. 312; *Nolan v. Whitney*, 88 N. Y. 648.) But that is not this case.... The defendant had a right to contract for what he wanted. He had a right before making payment to get what the contract called for. It is no answer to this suggestion to say that the pipe put in was just as good as that made by the Reading Manufacturing Company, or that the difference in value between such pipe and the pipe made by the Reading Manufacturing Company would be either 'nominal or nothing.' Defendant contracted for pipe made by the Reading Manufacturing Company. What his reason was for requiring this kind of pipe is of no importance. He wanted that and was entitled to it. It may have been a mere whim on his part, but even so, he had a right to this kind of pipe, regardless of whether some other kind, according to the opinion of the contractor or experts, would have been 'just as good, better, or done just as well.' He agreed to pay only upon condition that the pipe installed were made by that company and he ought not to be compelled to pay unless that condition be performed.....

For the foregoing reasons I think the judgment of the Appellate Division should be reversed and the judgment of the Trial Term affirmed.

HISCOCK, Ch. J., HOGAN and CRANE, JJ., concur with CARDOZO, J.; POUND and ANDREWS, JJ., concur with MCLAUGHLIN, J.

Notes and Questions

1. The disappointed contractor, Jacob & Youngs Inc., is the plaintiff suing for payments for home construction withheld by the homeowner, George Kent. Kent's own disappointment stems from his discovery that the contractor failed to install the brand of pipe Kent preferred. The court concluded the correct remedy was not the cost of removing the wrong brand of pipe and installing the correct brand, but the difference in market value between a house with the wrong pipe and a house with the right pipe. Do you suspect, if cost of completion were awarded, that Kent would have spent the award on dismantling the house and installing new pipe?
2. If other mansion owners were observing this case, who might they be rooting for and why? Who would other builders root for?
3. Some people have strong feelings about some brands. For example, Coke drinkers are famously dissatisfied with Pepsi as a substitute. Imagine George Kent was hosting a wedding party for his Coke-loving daughter, her new spouse, and their families. Jacob and Youngs, hired to cater the wedding, provided Pepsi products instead of the Coke products specified in the contract. Pepsi products sell for the same price, so a court might reasonably conclude they are equivalent in market value. Indeed, some blind taste tests suggest people prefer the taste of Pepsi, even if they say they prefer Coke in a non-blind test. *See, e.g., Samuel M. McClure et al., Neural Correlates of Behavioral Preference for Culturally Familiar Drinks, 44 NEURON 379, 384 (2004).*
 - a. Do you believe Coke and Pepsi are equivalent – i.e., a caterer could harmlessly replace one for the other?
 - b. Do you think the Kents would conclude they are equivalent?
 - c. If you think Coke and Pepsi are not equivalent, what might a court be missing about the difference between beverage brands if it uses diminution in market value to calculate damages?
 - d. How are branded plumbing pipes different from branded soft drinks, if at all?

4. This famous case touches on topics that go beyond the calculation of expectation damages, such as a party's power to suspending its contractual obligations and to terminate the contract. We discuss those issues in the section on constructive conditions and material breach (including by exploring the pertinent facts in *Jacobs & Young*). For a deeper dive into the case and the issues it raises we recommend RICHARD DANZIG & GEOFFREY R. WATSON, *THE CAPABILITY PROBLEM IN CONTRACT LAW: FURTHER READINGS ON WELL-KNOWN CASES* 96 – 100 (2d ed. 2004).

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Peevyhouse v. Garland Coal & Mining Co.

382 P.2d 109 (Supreme Court of Oklahoma 1963)

JACKSON, Justice.

In the trial court, plaintiffs Willie and Lucille Peevyhouse sued the defendant, Garland Coal and Mining Company, for damages for breach of contract. Judgment was for plaintiffs in an amount considerably less than was sued for. Plaintiffs appeal and defendant cross-appeals.

In the briefs on appeal, the parties present their argument and contentions under several propositions; however, they all stem from the basic question of whether the trial court properly instructed the jury on the measure of damages.

Briefly stated, the facts are as follows: plaintiffs owned a farm containing coal deposits, and in November, 1954, leased the premises to defendant for a period of five years for coal mining purposes. A 'stripmining' operation was contemplated in which the coal would be taken from pits on the surface of the ground, instead of from underground mine shafts. In addition to the usual covenants found in a coal mining lease, defendant specifically agreed to perform certain restorative and remedial work at the end of the lease period. It is unnecessary to set out the details of the work to be done, other than to say that it would involve the moving of many thousands of cubic yards of dirt, at a cost estimated by expert witnesses at about \$29,000.00. However, plaintiffs sued for only \$25,000.00.

During the trial, it was stipulated that all covenants and agreements in the lease contract had been fully carried out by both parties, except the remedial work mentioned above; defendant conceded that this work had not been done.

Plaintiffs introduced expert testimony as to the amount and nature of the work to be done, and its estimated cost. Over plaintiffs' objections, defendant thereafter introduced expert

testimony as to the ‘diminution in value’ of plaintiffs’ farm resulting from the failure of defendant to render performance as agreed in the contract—that is, the difference between the present value of the farm, and what its value would have been if defendant had done what it agreed to do.

At the conclusion of the trial, the court instructed the jury that it must return a verdict for plaintiffs, and left the amount of damages for jury determination. On the measure of damages, the court instructed the jury that it might consider the cost of performance of the work defendant agreed to do, ‘together with all of the evidence offered on behalf of either party’.

It thus appears that the jury was at liberty to consider the ‘diminution in value’ of plaintiffs’ farm as well as the cost of ‘repair work’ in determining the amount of damages.

It returned a verdict for plaintiffs for \$5000.00 – only a fraction of the ‘cost of performance’, but more than the total value of the farm even after the remedial work is done.

On appeal, the issue is sharply drawn. Plaintiffs contend that the true measure of damages in this case is what it will cost plaintiffs to obtain performance of the work that was not done because of defendant’s default. Defendant argues that the measure of damages is the cost of performance ‘limited, however, to the total difference in the market value before and after the work was performed’.

It appears that this precise question has not heretofore been presented to this court. In *Ardizzone v. Archer*, 72 Okl. 70, this court held that the measure of damages for breach of a contract to drill an oil well was the reasonable cost of drilling the well, but here a slightly different factual situation exists. The drilling of an oil well will yield valuable geological information, even if no oil or gas is found, and of course if the well is a producer, the value of the premises increases. In the case before us, it is argued by defendant with some force that the performance of the remedial work defendant agreed to do will add at the most only a few hundred dollars to the value of plaintiffs’ farm, and that the damages should be limited to that amount because that is all plaintiffs have lost.

Plaintiffs rely on *Groves v. John Wunder Co.*, 205 Minn. 163. In that case, the Minnesota court, in a substantially similar situation, adopted the ‘cost of performance’ rule as opposed to the ‘value’ rule. The result was to authorize a jury to give plaintiff damages in the amount of \$60,000, where the real estate concerned would have been worth only \$12,160, even if the work contracted for had been done.

It may be observed that *Groves v. John Wunder Co.*, supra, is the only case which has come to our attention in which the cost of performance rule has been followed under circumstances where the cost of performance greatly exceeded the diminution in value resulting from the breach of contract. Incidentally, it appears that this case was decided by a plurality rather than a majority of the members of the court.

Defendant relies principally upon *Sandy Valley & E. R. Co., v. Hughes*, 194 S.W. 344; *Bigbam v. Wabash-Pittsburg Terminal Ry. Co.*, 223 Pa. 106; and *Sweeney v. Lewis Const. Co.*, 66 Wash. 490. These were all cases in which, under similar circumstances, the appellate courts followed the 'value' rule instead of the 'cost of performance' rule. Plaintiff points out that in the earliest of these cases (*Bigbam*) the court cites as authority on the measure of damages an earlier Pennsylvania tort case, and that the other two cases follow the first, with no explanation as to why a measure of damages ordinarily followed in cases sounding in tort should be used in contract cases. Nevertheless, it is of some significance that three out of four appellate courts have followed the diminution in value rule under circumstances where, as here, the cost of performance greatly exceeds the diminution in value.

The explanation may be found in the fact that the situations presented are artificial ones. It is highly unlikely that the ordinary property owner would agree to pay \$29,000 (or its equivalent) for the construction of 'improvements' upon his property that would increase its value only about (\$300) three hundred dollars. The result is that we are called upon to apply principles of law theoretically based upon reason and reality to a situation which is basically unreasonable and unrealistic.

The primary purpose of the lease contract between plaintiffs and defendant...was merely to accomplish the economical recovery and marketing of coal from the premises, to the profit of all parties. The special provisions of the lease contract pertaining to remedial work were incidental to the main object involved.

Even in the case of contracts that are unquestionably building and construction contracts, the authorities are not in agreement as to the factors to be considered in determining whether the cost of performance rule or the value rule should be applied. The American Law Institute's Restatement of the Law, Contracts, Volume 1, Sections 346(1)(a)(i) and (ii) submits the proposition that the cost of performance is the proper measure of damages 'if this is possible and does not involve unreasonable economic waste'; and that the diminution in value caused by the breach is the proper measure 'if construction and completion in accordance with the contract would involve unreasonable economic waste'. In an explanatory comment immediately following the text, the Restatement makes it clear that the 'economic waste'

referred to consists of the destruction of a substantially completed building or other structure. Of course no such destruction is involved in the case now before us.

On the other hand, in McCormick, Damages, Section 168, it is said with regard to building and construction contracts that ‘* * * in cases where the defect is one that can be repaired or cured without undue expense’ the cost of performance is the proper measure of damages, but where ‘* * * the defect in material or construction is one that cannot be remedied without an expenditure for reconstruction disproportionate to the end to be attained’ (emphasis supplied) the value rule should be followed. The same idea was expressed in *Jacob & Youngs, Inc. v. Kent*, 230 N.Y. 239, as follows:

‘The owner is entitled to the money which will permit him to complete, unless the cost of completion is grossly and unfairly out of proportion to the good to be attained. When that is true, the measure is the difference in value.’

It thus appears that the prime consideration in the Restatement was ‘economic waste’; and that the prime consideration in McCormick, Damages, and in *Jacob & Youngs, Inc. v. Kent*, supra, was the relationship between the expense involved and the ‘end to be attained’ – in other words, the ‘relative economic benefit’.

In view of the unrealistic fact situation in the instant case, and certain Oklahoma statutes to be hereinafter noted, we are of the opinion that the ‘relative economic benefit’ is a proper consideration here.

23 O.S.1961 §§ 96 and 97 provide as follows:

‘§ 96. * * * Notwithstanding the provisions of this chapter, no person can recover a greater amount in damages for the breach of an obligation, than he would have gained by the full performance thereof on both sides * * *.

‘§ 97. * * * Damages must, in all cases, be reasonable, and where an obligation of any kind appears to create a right to unconscionable and grossly oppressive damages, contrary to substantial justice no more than reasonable damages can be recovered.’

In spite of the agreement of the parties, these sections limit the damages recoverable to a reasonable amount not ‘contrary to substantial justice’; they prevent plaintiffs from recovering a ‘greater amount in damages for the breach of an obligation’ than they would have ‘gained by the full performance thereof’.

We therefore hold that where, in a coal mining lease, lessee agrees to perform certain remedial work on the premises concerned at the end of the lease period, and thereafter the contract is fully performed by both parties except that the remedial work is not done, the measure of damages in an action by lessor against lessee for damages for breach of contract is ordinarily the reasonable cost of performance of the work; however, where the contract provision breached was merely incidental to the main purpose in view, and where the economic benefit which would result to lessor by full performance of the work is grossly disproportionate to the cost of performance, the damages which lessor may recover are limited to the diminution in value resulting to the premises because of the non-performance.

* * *

Under the most liberal view of the evidence herein, the diminution in value resulting to the premises because of non-performance of the remedial work was \$300.00. After a careful search of the record, we have found no evidence of a higher figure, and plaintiffs do not argue in their briefs that a greater diminution in value was sustained. It thus appears that the judgment was clearly excessive, and that the amount for which judgment should have been rendered is definitely and satisfactorily shown by the record.

* * *

WELCH, DAVISON, HALLEY, and JOHNSON, JJ., concur.

WILLIAMS, C. J., BLACKBIRD, V. C. J., and IRWIN and BERRY, JJ., dissenting.

IRWIN, Justice (dissenting).

Following the expiration of the lease, plaintiffs made demand upon defendant that it carry out the provisions of the contract and to perform those covenants contained therein.

Defendant admits that it failed to perform its obligations that it agreed and contracted to perform under the lease contract and there is nothing in the record which indicates that defendant could not perform its obligations. Therefore, in my opinion defendant's breach of the contract was wilful and not in good faith.

Although the contract speaks for itself, there were several negotiations between the plaintiffs and defendant before the contract was executed. Defendant admitted in the trial of the action,

that plaintiffs insisted that the above provisions be included in the contract and that they would not agree to the coal mining lease unless the above provisions were included.

In consideration for the lease contract, plaintiffs were to receive a certain amount as royalty for the coal produced and marketed and in addition thereto their land was to be restored as provided in the contract.

Defendant received as consideration for the contract, its proportionate share of the coal produced and marketed and in addition thereto, the right to use plaintiffs' land in the furtherance of its mining operations.

The cost for performing the contract in question could have been reasonably approximated when the contract was negotiated and executed and there are no conditions now existing which could not have been reasonably anticipated by the parties. Therefore, defendant had knowledge, when it prevailed upon the plaintiffs to execute the lease, that the cost of performance might be disproportionate to the value or benefits received by plaintiff for the performance.

Defendant has received its benefits under the contract and now urges, in substance, that plaintiffs' measure of damages for its failure to perform should be the economic value of performance to the plaintiffs and not the cost of performance.

If a peculiar set of facts should exist where the above rule should be applied as the proper measure of damages, (and in my judgment those facts do not exist in the instant case) before such rule should be applied, consideration should be given to the benefits received or contracted for by the party who asserts the application of the rule.

Defendant did not have the right to mine plaintiffs' coal or to use plaintiffs' property for its mining operations without the consent of plaintiffs. Defendant had knowledge of the benefits that it would receive under the contract and the approximate cost of performing the contract. With this knowledge, it must be presumed that defendant thought that it would be to its economic advantage to enter into the contract with plaintiffs and that it would reap benefits from the contract, or it would have not entered into the contract.

...[S]ince defendant has failed to perform, the proper measure of damages should be the cost of performance. Any other measure of damage would be holding for naught the express provisions of the contract; would be taking from the plaintiffs the benefits of the contract and

placing those benefits in defendant which has failed to perform its obligations; would be granting benefits to defendant without a resulting obligation; and would be completely rescinding the solemn obligation of the contract for the benefit of the defendant to the detriment of the plaintiffs by making an entirely new contract for the parties.

I therefore respectfully dissent to the opinion promulgated by a majority of my associates.

Notes and Questions

1. The majority in *Peevyhouse* described the provision requiring Garland Coal to backfill the scar cut across the Peevyhouse farm as “incidental to the main object” of the contract. There is evidence indicating that the Peevyhouses were quite invested in that clause. They negotiated for the remediation clause, while none of their neighbors who leased strip mining rights on their farms did so. Moreover, Garland Coal required a concession from the Peevyhouses: they did not receive a \$3,000 payment upon executing the lease that their neighbors received. *See* Judith L. Maute, *Peevyhouse v. Garland Coal & Mining Co. Revisited: The Ballad of Willie and Lucille*, 89 NW. U. L. REV. 1341, 1347 (1995).
 - a. If the Peevyhouses were willing to give up \$3,000 to secure the promise from Garland Coal to fill in the strip mine scar, what does that tell you about the value of Garland Coal’s breached promise to the Peavyhouses?
 - b. If Garland Coal had refused to promise to close the strip mine, do you suspect the Peevyhouses would have taken the \$3,000 payment, or denied mining rights altogether?
2. Who would the Peevyhouses’ neighbors root for in the case and why?
3. The court in *Peevyhouse* concludes in part that it is bound by an Oklahoma statute requiring application of diminution of value as the correct damages measure. Section 96 of that statute specified “no person can recover a greater amount in damages for the breach of an obligation, than he would have gained by the full performance thereof on both sides.” The court’s interpretation of this provision highlights one tension in using expectation damages to give the parties the benefit of their bargain. Had Garland Coal fully performed, the strip-mining scar on the Peevyhouse farm would have been filled in, and the damage more or less remediated. Granting expectation damages

limited to diminution in market value fails to give the Peevyhouses what full performance would have granted.

4. Do you think the Peevyhouses would have used the \$29,000 requested to remediate the land? Even if they wanted to, who was going to pay their lawyers?
5. Reconsider the Coke v. Pepsi hypothetical from *Jacob & Youngs*. In that hypothetical, there may well be subjective value that is difficult to calculate using a market measure. Is the court in *Peevyhouse* similarly undercounting the subjective value to the Peevyhouses of land remediation?
6. If the court is worried about waste and uncertain about subjective value, would it be better to issue an order of specific performance requiring Garland to fill in the strip-mining scar? If that isn't what the Peevyhouses actually want, how might they respond?

* * *

American Standard Inc. v. Schectman

439 N.Y.S.2d 529 (N.Y. Appellate Division 1981)

HANCOCK, Judge:

Plaintiffs have recovered a judgment on a jury verdict of \$90,000 against defendant for his failure to complete grading and to take out certain foundations and other subsurface structures to one foot below the grade line as promised. Whether the court should have charged the jury, as defendant Schectman requested, that the difference in value of plaintiffs' property with and without the promised performance was the measure of the damage is the main point in his appeal. We hold that the request was properly denied and that the cost of completion – not the difference in value – was the proper measure. Finding no basis for reversal, we affirm.

Until 1972, plaintiffs operated a pig iron manufacturing plant on land abutting the Niagara River in Tonawanda. On the 26-acre parcel were, in addition to various industrial and office buildings, a 60-ton blast furnace, large lifts, hoists and other equipment for transporting and storing ore, railroad tracks, cranes, diesel locomotives and sundry implements and devices used in the business. Since the 1870's plaintiffs' property, under several different owners, had been the site of various industrial operations. Having decided to close the plant, plaintiffs on August 3, 1973 made a contract in which they agreed to convey the buildings and other structures and most of the equipment to defendant, a demolition and excavating contractor, in return for defendant's payment of \$275,000 and his promise to remove the equipment, demolish the structures and grade the property as specified.

We agree with Trial Term's interpretation of the contract as requiring defendant to remove all foundations, piers, headwalls, and other structures, including those under the surface and not visible and whether or not shown on the map attached to the contract, to a depth of approximately one foot below the specified grade lines. The proof from plaintiffs' witnesses and the exhibits, showing a substantial deviation from the required grade lines and the existence above grade of walls, foundations and other structures, support the finding, implicit in the jury's verdict, that defendant failed to perform as agreed. Indeed, the testimony of defendant's witnesses and the position he has taken during his performance of the contract and throughout this litigation (which the trial court properly rejected), viz., that the contract did not require him to remove all subsurface foundations, allow no other conclusion.

We turn to defendant's argument that the court erred in rejecting his proof that plaintiffs suffered no loss by reason of the breach because it makes no difference in the value of the property whether the old foundations are at grade or one foot below grade and in denying his offer to show that plaintiffs succeeded in selling the property for \$183,000 – only \$3,000 less than its full fair market value. By refusing this testimony and charging the jury that the cost of completion (estimated at \$110,500 by plaintiffs' expert), not diminution in value of the property, was the measure of damage the court, defendant contends, has unjustly permitted plaintiffs to reap a windfall at his expense. Citing the definitive opinion of Judge Cardozo in *Jacob & Youngs v. Kent*, 230 N.Y. 239, he maintains that the facts present a case “of substantial performance” of the contract with omissions of “trivial or inappreciable importance” (p 245) and that because the cost of completion was “grossly and unfairly out of proportion to the good to be attained” (p 244), the proper measure of damage is diminution in value.

The general rule of damages for breach of a construction contract is that the injured party may recover those damages which are the direct, natural and immediate consequence of the breach and which can reasonably be said to have been in the contemplation of the parties when the contract was made (see 13 N.Y. Jur., Damages, §§ 46, 56; *Chamberlain v. Parker*, 45 N.Y. 569; *Hadley v. Baxendale*, 9 Exch. [Welsby, Hurlstone & Gordon] 341; Restatement, Contracts, § 346). In the usual case where the contractor's performance has been defective or incomplete, the reasonable cost of replacement or completion is the measure (see *Bellizzi v. Huntley Estates*, 3 N.Y.2d 112; *Spence v. Ham*, 163 N.Y. 220; *Condello v. Stock*, 285 App. Div. 861, mod on other grounds 1 N.Y.2d 831; *Along-The-Hudson Co. v. Ayres*, 170 App. Div. 218; 13 N.Y. Jur., Damages, § 56, p 502; Restatement, Contracts, § 346). When, however, there has been a substantial performance of the contract made in good faith but defects exist, the correction of which would result in economic waste, courts have measured the damages as the difference between the value of the property as constructed and the value if performance had been

properly completed (see *Jacob & Youngs v. Kent*, *supra*; *Drober & Sons v. Toushin*, 250 Minn. 490; Restatement, Contracts, § 346, subd [1], par [a], cl [ii], p 573; comment *b*, p 574; 13 N.Y. Jur, Damages, § 58; Ann., 76 ALR2d 805, § 4, pp 812-815). *Jacob & Youngs* is illustrative. There, plaintiff, a contractor, had constructed a house for the defendant which was satisfactory in all respects save one: the wrought iron pipe installed for the plumbing was not of Reading manufacture, as specified in the contract, but of other brands of the same quality. Noting that the breach was unintentional and the consequences of the omission trivial, and that the cost of replacing the pipe would be “grievously out of proportion” (*Jacob & Youngs v. Kent*, *supra*, p 244) to the significance of the default, the court held the breach to be immaterial and the proper measure of damage to the owner to be not the cost of replacing the pipe but the nominal difference in value of the house with and without the Reading pipe.

Not in all cases of claimed “economic waste” where the cost of completing performance of the contract would be large and out of proportion to the resultant benefit to the property have the courts adopted diminution in value as the measure of damage. Under the Restatement rule, the completion of the contract must involve “unreasonable economic waste” and the illustrative example given is that of a house built with pipe different in name but equal in quality to the brand stipulated in the contract as in *Jacob & Youngs v. Kent* (230 N.Y. 239, *supra*) (Restatement, Contracts, § 346, subd [1], par [a], cl [ii], p 573; Illustration No. 2, p 576). In *Groves v. Wunder Co.* (205 Minn. 163), plaintiff had leased property and conveyed a gravel plant to defendant in exchange for a sum of money and for defendant’s commitment to return the property to plaintiff at the end of the term at a specified grade -- a promise defendant failed to perform. Although the cost of the fill to complete the grading was \$60,000 and the total value of the property, graded as specified in the contract, only \$12,160 the court rejected the “diminution in value” rule, stating: “The owner’s right to improve his property is not trammelled by its small value. It is his right to erect thereon structures which will reduce its value. If that be the result, it can be of no aid to any contractor who declines performance. As said long ago in *Chamberlain v. Parker*, 45 N.Y. 569, 572: ‘A man may do what he will with his own, ... and if he chooses to erect a monument to his caprice or folly on his premises, and employs and pays another to do it, it does not lie with a defendant who has been so employed and paid for building it, to say that his own performance would not be beneficial to the plaintiff.’” (*Groves v. Wunder Co.*, *supra*, p 168.)

The “economic waste” of the type which calls for application of the “diminution in value” rule generally entails defects in construction which are irremediable or which may not be repaired without a substantial tearing down of the structure as in *Jacob & Youngs* (see *Bellizzi v. Huntley Estates*, 3 N.Y.2d 112, 115, *supra*; *Groves v. Wunder Co.*, *supra*; *Slugg Seed & Fertilizer v.*

Paulson Lbr., 62 Wis. 2d 220; Restatement, Contracts, § 346, subd [1], Illustration Nos. 2, 4, pp 576-577; Ann., 76 ALR2d 805, § 4, pp 812-815).

Where, however, the breach is of a covenant which is only incidental to the main purpose of the contract and completion would be disproportionately costly, courts have applied the diminution in value measure even where no destruction of the work is entailed (see, e.g., *Peeryhouse v. Garland Coal & Min. Co.*, 382 P.2d 109 [Okla], cert den 375 U.S. 906, holding [contrary to *Groves v. Wunder Co.*, *supra*] that diminution in value is the proper measure where defendant, the lessee of plaintiff's lands under a coal mining lease, failed to perform costly remedial and restorative work on the land at the termination of the lease. The court distinguished the “building and construction” cases and noted that the breach was of a covenant incidental to the main purpose of the contract which was the recovery of coal from the premises to the benefit of both parties; and see *Avery v. Fredericksen & Westbrook*, 67 Cal. App. 2d 334).

It is also a general rule in building and construction cases, at least under *Jacob & Youngs* (*supra*) in New York (see *Groves v. Wunder Co.*, *supra*; Ann., 76 ALR2d 805, § 6, pp 823-826), that a contractor who would ask the court to apply the diminution of value measure “as an instrument of justice” must not have breached the contract intentionally and must show substantial performance made in good faith (*Jacob & Youngs v. Kent*, *supra*, pp 244, 245).

In the case before us, plaintiffs chose to accept as part of the consideration for the promised conveyance of their valuable plant and machines to defendant his agreement to grade the property as specified and to remove the foundations, piers and other structures to a depth of one foot below grade to prepare the property for sale. It cannot be said that the grading and the removal of the structures were incidental to plaintiffs' purpose of “achieving a reasonably attractive vacant plot for resale” (cf. *Peeryhouse v. Garland Coal & Min. Co.*, *supra*). Nor can defendant maintain that the damages which would naturally flow from his failure to do the grading and removal work and which could reasonably be said to have been in the contemplation of the parties when the contract was made would not be the reasonable cost of completion (see 13 N.Y. Jur, Damages, §§ 46, 56; *Hadley v. Baxendale*, 9 Exch. [Welsby, Hurlstone & Gordon] 341, *supra*). That the fulfillment of defendant's promise would (contrary to plaintiffs' apparent expectations) add little or nothing to the sale value of the property does not excuse the default. As in the hypothetical case, posed in *Chamberlain v. Parker* (45 N.Y. 569, *supra*) (cited in *Groves v. Wunder Co.*, 205 Minn. 163, *supra*), of the man who “chooses to erect a monument to his caprice or folly on his premises, and employs and pays another to do it”, it does not lie with defendant here who has received consideration for his promise to do the

work “to say that his own performance would not be beneficial to the [plaintiffs]” (*Chamberlain v. Parker*, *supra*, p 572).

Defendant’s completed performance would not have involved undoing what in good faith was done improperly but only doing what was promised and left undone (cf. *Jacob & Youngs v. Kent*, 230 N.Y. 239, *supra*; Restatement, Contracts, § 346, subd [1], Illustration No. 2, p 576). That the burdens of performance were heavier than anticipated and the cost of completion disproportionate to the end to be obtained does not, without more, alter the rule that the measure of plaintiffs’ damage is the cost of completion. Disparity in relative economic benefits is not the equivalent of “economic waste” which will invoke the rule in *Jacob & Youngs v. Kent* (*supra*) (see *Groves v. Wunder Co.*, *supra*). Moreover, faced with the jury’s finding that the reasonable cost of removing the large concrete and stone walls and other structures extending above grade was \$90,000, defendant can hardly assert that he has rendered substantial performance of the contract or that what he left unfinished was “of trivial or inappreciable importance” (*Jacob & Youngs v. Kent*, *supra*, p 245). Finally, defendant, instead of attempting in good faith to complete the removal of the underground structures, contended that he was not obliged by the contract to do so and, thus, cannot claim to be a “transgressor whose default is unintentional and trivial [and who] may hope for mercy if he will offer atonement for his wrong” (*Jacob & Youngs v. Kent*, *supra*, p 244). We conclude, therefore, that the proof pertaining to the value of plaintiffs’ property was properly rejected and the jury correctly charged on damages.

The judgment and order should be affirmed.

Simons, J. P., Doerr, Denman and Schnepf, JJ., concur.

Judgment and order unanimously affirmed, with costs.

Notes and Questions

1. The court in *American Standard* cites a hypothetical from *Chamberlain v. Parker*, 45 N.Y. 569, about a contract to “erect a monument to [the owner’s] caprice or folly.” The contractor who breaches the contract to erect the monument could not successfully argue that there are no damages even if experts would argue that the property in question with the monument would have a reduced value compared to the unadorned property. This “ugly fountain” hypothetical suggests that in some cases, diminution in market value is beside the point. Breach of a contract to meet the hiring party’s

idiosyncratic tastes should rarely be subject to the diminution of market value rule because that rule won't correctly account for the promisee's subjective tastes.

2. Think back on *Peevyhouse*. The family continued to live on the farm after its unfortunate transaction with Garland Coal. Is a family farm more like a commercial investment, where diminution in market value may provide the most accurate calculation or at least prevent wasteful windfalls, or more like an "ugly fountain" for which cost of completion may more accurately reflect the subjective value of the promise to the promisee?
3. When the parties negotiated the contract, Schechtman was promised the equipment from American Standard's abandoned pig iron factory. In exchange, Schechtman promised to pay \$275,000, remove the equipment, demolish the structures, and grade the property. If Schechtman had been unwilling to take on the obligation to grade the property when the contract was negotiated, how might American Standard have responded? How might the contract have changed?

* * *

Lyon v. Belosky Construction Inc.

247 A.D.2d 730 (N.Y. App. 1998)

CARDONA, Presiding Justice, Judge.

Appeal from a judgment of the Supreme Court (Ellison, J.), entered November 11, 1996 in Chemung County, upon a decision of the court in favor of plaintiffs.

In October 1993, plaintiff Mary C. Lyon and her sister, plaintiff Martha Clute, entered into a contract with defendant Belosky Construction Inc. for the construction of a custom home in the City of Elmira, Chemung County, at a base cost of \$247,000 with approximately \$42,000 in additional features. Lyon, who is a resident of South Carolina, retained an architectural firm in South Carolina to prepare the design drawings. Upon Belosky's advice, plaintiffs retained defendant Kirk Vieselmeyer, a professional engineer, to, *inter alia*, prepare construction documents and conduct periodic inspections to insure that the home was constructed in conformity with the drawings.

Construction commenced in November 1993. In April 1994, plaintiffs became aware of a problem with a dormer over the main entrance of the home.* The dormer was removed and rebuilt. Plaintiffs, however, found the rebuilt dormer unsatisfactory and directed Belosky to remove it. The home was subsequently completed with the exception of the interior and exterior of the main entrance. After moving into the home, plaintiffs learned that the roof had been centered over the library rather than the living room as represented in the drawings resulting in a change in the roof proportions and enlargement of the overhang over the main entrance. In addition, the entrance pillars could not be used in the manner depicted in the drawings.

Plaintiffs subsequently commenced this action against defendants for breach of contract. In their respective answers, defendants raised, *inter alia*, the affirmative defense of economic waste claiming that damages, if any, should be based upon the diminution in value of the structure rather than the value of replacement. Following a nonjury trial, Supreme Court found that defendants had breached their respective contracts and plaintiffs were entitled to damages in an amount necessary to replace the roof so as to bring it in conformity with the drawings. Supreme Court awarded plaintiffs judgment in the sum of \$73,182.66, the agreed-upon cost of replacement including costs and interest. Defendants appeal.

We affirm. As a general rule, the proper measure of damages in cases involving the breach of a construction contract is “the difference between the amount due on the contract and the amount necessary to properly complete the job or to replace the defective construction, whichever is appropriate” (*citations omitted*).

It is undisputed that the defect in the main entrance, including the overhead dormer, was due to the misalignment of the roof which was constructed under the supervision and control of Belosky and purportedly overseen by Vieselmeyer. Belosky hired a framer to frame the roof but testified that he did not personally inspect the roof to insure that it and the dormer complied with the drawings. In fact, Belosky admitted that he had little experience reading drawings and relied upon the framer to whom he had subcontracted the work to make sure the home was constructed properly. Vieselmeyer, who was specifically hired to inspect the construction to make sure that it complied with the drawings, did not discover the problem with the roof until after he took certain field measurements at the request of plaintiffs’

* A dormer is a vertical window set on a slanted roof. The dormer or dormer window has its own roof. The dormer adds an additional visual dimension to a slanted roof, and also provides light, ventilation, and space to the floor under the roof. Eds.

architect. By this time, however, the dormer had already been rebuilt and removed, and the entire roof had been shingled. Inasmuch as plaintiffs' expert testified that the misalignment of the roof should have been discovered when problems with the dormer became apparent, the evidence supports Supreme Court's finding that defendants, at the very least, acted negligently in failing to detect the problem.

In addition, there is evidence that, under the circumstances presented here, the defect was substantial. Plaintiffs contracted to build a custom home at significant expense which, in fact, exceeded the fair market value of the home as completed per the drawings. Because they were away from the work site during most of the construction, plaintiffs retained and relied upon various professionals to assist them in successfully completing the project. It is clear from the record that the aesthetic appearance of the home, both inside and out, was of utmost importance to plaintiffs. Our review of the photographs of the home as constructed compared with the design drawings convinces us that plaintiffs did not get the benefit of their bargain and that requiring defendants to remedy the problem would not, under these particular circumstances, result in unreasonable economic waste. Accordingly, we find that Supreme Court applied the appropriate measure of damages (*cf.*, *Jacob & Youngs v. Kent*, 230 N.Y. 239). Lastly, inasmuch as the evidence establishes that Vieselmeyer's breach of contract was a proximate cause of the damages sustained by plaintiffs, Supreme Court properly awarded judgment against him notwithstanding the relatively small fee he charged for services rendered to plaintiffs.

ORDERED that the judgment is affirmed, with costs.

MERCURE, WHITE, SPAIN and CARPINELLO, JJ., concur..

Notes and Questions

1. How is *Lyon* distinguishable from *Jacob & Youngs*? From *Peevyhouse*?
2. If you had to categorize the four cases in this module in order from cases where diminution in market value was the least appropriate to the most appropriate measure, how would you categorize them?