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Of Spoil Pits and Swimming Pools: Reconsidering the Measure of Damages for Construction Contracts

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INTRODUCTION

To obtain a remedy in a breach of contract suit, a party must prove, and courts must determine, what damage the breach has caused. The general rule is straightforward: A party injured by a breach of contract is entitled to be placed in as good a position as if the contract had been performed.[1] Applying the general rule to specific circumstances — computing what it means to be placed in "as good a position as if the contract had been performed" — is more difficult.

One recurring problem concerns the proper measure of damages when a construction contractor partially or defectively performs. Typically, the owner of the structure being built or repaired comes to court asking for an award of damages sufficient to hire someone else to finish the job properly.[2] Often,

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1. This is commonly referred to as the injured party's "expectation interest." *See* RESTATEMENT (SECOND) OF CONTRACTS §§ 344(a), 347 (1979). In appropriate cases, the promisee may instead be entitled to protection of her "reliance interest" by being returned to the position she held before the contract was entered or her "restitution interest" by having restored to her any benefit conferred on the other party. *See generally id.* §§ 344(b), (c); Fuller & Perdue, *The Reliance Interest in Contract Damages (pts. 1 & 2)*, 46 YALE L.J. 52, 373 (1936); Hudec, *Restating the "Reliance Interest,"* 67 CORNELL L. REV. 704 (1982); Perillo, *Restitution in a Contractual Context*, 73 COLUM. L. REV. 1208 (1973); Perillo, *Restitution in the Second Restatement of Contracts*, 81 COLUM. L. REV. 37 (1981). Protection of expectation has generally been the preferred remedy. *See* Farnsworth, *Legal Remedies for Breach of Contract*, 70 COLUM. L. REV. 1145, 1175 (1970). The preference for expectation damages has been subject to some challenge, however. *See* P.S. ATIYAH, ESSAYS ON CONTRACT 150-178 (1986). Because of the nature of the cases considered in this Article, very few of them are candidates for reliance or restitution damages. *See infra* note 175.

2. Depending upon whether the owner has already paid for the defective

the contractor responds that the owner is not entitled to receive such "cost to complete" damages but should collect only the "diminution in market value" — the difference in market value between the property as it is with defective performance and the property as it would be if the contractor had fully performed.

Judge Cardozo's opinion in *Jacob & Youngs, Inc. v. Kent*,[3] rendered in 1921, is often cited as a foundation for the choice between "cost to complete" and "diminution in value." George Kent contracted with Jacob & Youngs to build a country residence in Jericho, New York, at a cost in excess of $77,000. The construction contract specified that "[a]ll wrought-iron pipe must be well galvanized, lap welded pipe of the grade known as 'standard pipe' of Reading manufacture."[4] When Kent discovered that Jacob & Youngs failed to use Reading pipe in much of the construction, he demanded that the contractor replace the pipe in order to conform with the specifications. The contractor refused because most of the pipe was already encased in the walls of the house, and replacing it would entail demolition and rebuilding of substantial portions of the already completed structure.[5]

Jacob & Youngs sued Kent to recover $3,483.46, the unpaid portion of the contract price. At trial, Jacob & Youngs offered to prove that the pipe used in the construction was of the same quality, appearance, and market value as Reading pipe,[6] but the trial court excluded this evidence and entered a directed verdict for Kent.[7] On appeal, the Court of Appeals of New York reversed, holding that Jacob & Youngs was entitled to receive the unpaid balance of the contract price, less damages for the in-

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work, she may appear either as plaintiff, seeking a remedy for breach, or as defendant, responding to the contractor's suit for payment and possibly counterclaiming for damages. The positioning of owner and contractor as plaintiff or defendant does not seem to affect the outcome of the litigation, except where the owner as defendant appears to be using the claims of defective work to mask other concerns. *See infra* note 13.

Alternatively, an owner may seek specific performance of the contract. Such relief is rarely requested in these cases, however, because of the general reluctance of courts to award specific performance when personal services are involved and because the owner usually does not want the work completed by the same contractor who performed inadequately.

3. 230 N.Y. 239, 129 N.E. 889 (1921).

4. *Id.* at 240, 129 N.E. at 890.

5. *Id.* at 241-42, 129 N.E. at 890-91.

6. *Id.*

7. *Id.*

jury it caused by failing to fully perform the contract.[8] The court found the offered evidence should have been admitted because it was relevant for determining the extent of the contractor's deviation from the specifications and thus for computing the amount by which to reduce the contractor's recovery. Although the usual measure of damages for failure to perform a contract would be the cost to complete the promised work, the court concluded that an owner would not be entitled to that measure if "the cost of completion is grossly and unfairly out of proportion to the good to be attained."[9] In such circumstances, the owner should receive the difference in value between the work as done and the work as promised.[10] Thus, if Jacob & Youngs could prove that the work was of the same quality as promised, even though a different kind of pipe was used, then Kent would recover nothing as a set-off to the contractor's bill.

Almost everyone who encounters the *Jacob & Youngs* decision approves the result Judge Cardozo reached. The appropriateness of the holding becomes more apparent when one considers the facts of the case in more depth. The contract apparently specified Reading pipe only to provide a standard to ensure that Jacob & Youngs used pipe of the proper quality.[11] Neither in the contract itself nor in the ensuing litigation did George Kent ever articulate any reason for preferring Reading pipe over pipe of the same quality, appearance, and market value. After exploring the background of the dispute, Richard Danzig concluded that Kent was dissatisfied in some ways with the work done and had "seized upon the pipe substitution" as a tool in his battle with the contractor.[12] Given Kent's failure to justify in any way his insistence upon Reading pipe rather than the substitute actually used, it seems sensible to rule that he was not entitled to damages in an amount sufficient to allow him to tear down much of the interior of the completed house

8. *Id.* at 244, 129 N.E. at 891.

9. *Id.*

10. *Id.*

11. R. DANZIG, THE CAPABILITY PROBLEM IN CONTRACT LAW 122 (1978). Some manufacturers used names for their pipe that makers of "genuine wrought iron pipe" thought misleading. In order to avoid confusion, trade publications suggested specifying a particular manufacturer that was known to produce pipe of the quality desired so that only pipe of that standard would be used. The contract between Kent and Jacob & Youngs also contained language suggesting that the specification of Reading pipe was meant only to specify a standard, not to require absolutely that no other brand be used. *Id.*; *see infra* note 14.

12. R. DANZIG, *supra* note 11, at 123.

and replace the pipe already there.[13] In Judge Cardozo's words, there was no "good to be attained" by requiring precise enforcement of the contract terms,[14] so the court should not award damages designed to permit completion according to those precise terms.[15]

Jacob & Youngs, then, is a case that applies the "diminution in market value" rule in a satisfying way. But *Jacob & Youngs* is an easy case. It is the more difficult cases, where the choice between "cost to complete" and "diminution in value" is harder, that test the boundaries of the rule. One such case is the classic *Peevyhouse v. Garland Coal & Mining Company*.[16]

Willie and Lucille Peevyhouse agreed to lease a portion of their farm to the Garland Coal & Mining Company for five years during which time the Company intended to carry out strip mining operations. In the contract, the Company agreed to restore the contours of the land when it completed the mining.[17] After conducting some preliminary mining, the Company

13. In fact, Kent was not actually seeking damages in an amount sufficient to allow him to replace the pipe. He simply refused to pay the final installment due on the contract and defended his refusal to pay by insisting that the contractor had not completed the job properly and therefore was not entitled to payment. *Jacob & Youngs*, 230 N.Y. at 240, 129 N.E. at 890. The tactical use made of the issue adds to the sense that Kent was simply using the complaints about the pipe as a weapon in his battles with the contractor. It seems quite clear that he did not intend to replace the pipe and probably had no real preference for one brand over another.

14. Although the trial court apparently held, and Cardozo did not question, that Jacob & Youngs had breached the contract by providing a different brand of pipe, the contract required only "well galvanized, lap welded pipe *of the grade known as* 'standard pipe' of Reading manufacture." *Jacob & Youngs*, 230 N.Y. at 240, 129 N.E. at 890 (emphasis added). The court might have avoided the damages issue entirely by holding that the contract required only pipe of equivalent quality (grade) to Reading standard pipe, and thus that there was no breach of the contract specifications.

15. The three dissenters in *Jacob & Youngs*, however, argued that the specification of Reading pipe was essentially a condition of payment; without perfect compliance, Kent was not obligated to pay. *Jacob & Youngs*, 230 N.Y. at 247, 129 N.E. at 892 (McLaughlin, J., dissenting). There seems to be virtually no support in the case law or among theorists for that conclusion. *But see* Morgan v. Gamble, 230 Pa. 165, 172-73, 79 A. 410, 413 (1911) (contractor not relieved of responsibility to follow specifications though work performed was just as good as that required in contract).

It is not clear whether Cardozo's result would have been different if, on similar facts, the owner had articulated a reason why, to him, the choice of Reading pipe was crucial. *See infra* note 49 and accompanying text. Cardozo does not indicate whether the "good to be attained" is to be judged from the perspective of the owner or from some independent perspective.

16. 382 P.2d 109 (Okla. 1962), *cert. denied*, 375 U.S. 906 (1963).

17. *Id.* at 111.

abandoned the operation and refused to restore the land as specified by the contract; the Company later claimed that the land contained less coal than it had anticipated, making restoration much more expensive than estimated.[18] The Peevyhouses sued for breach of contract.

At trial, the Peevyhouses showed that restoring the land would cost $29,000. The Company responded with evidence that the failure to restore the land decreased its market value by only $300.[19] The jury granted damages in the amount of $5,000; on appeal the Oklahoma Supreme Court reduced the award to $300.[20] The court determined that the cost to restore the land was "grossly disproportionate" to the economic benefit of full performance — the "good to be attained" — so the Peevyhouses could recover only the diminution in value of their land.[21]

Is *Peevyhouse* just like *Jacob & Youngs*? In both cases, the owner of a piece of property specified by contract that certain work be done. In both cases, the post-breach cost to comply with the terms of the contract was high, while the effect of the breach on the market value of the property was small or nonexistent. Because of that disproportion, the court in both cases found the owner entitled to receive only the diminution in market value, if any, that the failure to perform caused.

Yet, the two cases seem different in some fundamental ways. Kent was a wealthy New York lawyer who seemed to be using a technicality to avoid payment in full of his own contract obligations;[22] the Peevyhouses were Oklahoma farmers, trying to enforce a clause that had been of critical importance in inducing them to sign the contract.[23] Kent's desire for Reading pipe seems unjustified; the Peevyhouses' desire to have their

18. L. FULLER & M. EISENBERG, BASIC CONTRACT LAW 196 (1981) (quoting from the brief filed by Garland Coal & Mining Co.). In fact, the operations map shows that the coal on the Peevyhouse land was at the same depth as on neighboring properties that were more extensively mined. Moreover, Garland's argument that the restoration was more expensive because mining was suspended appears for the first time in a brief that Garland filed *after* the Oklahoma Supreme Court decision. At trial, Garland justified its failure to restore by arguing that the restoration would be economically wasteful. Telephone conversation with Professor Judith Maute, University of Oklahoma Law Center (July 8, 1991).

19. *Peevyhouse*, 382 P.2d at 111-12.

20. *Id.* at 111, 114.

21. *Id.* at 114.

22. R. DANZIG, *supra* note 11, at 120.

23. *Peevyhouse*, 382 P.2d at 115.

land restored strikes a responsive chord, especially in modern environmentally conscious times. Everyone, it seems, wants the Peevyhouses to win; no one has much sympathy for Kent. But can we effectively distinguish between the two cases? Should Kent and the Peevyhouses receive the same or different remedies? How would these cases be decided today? Are courts resolving these issues consistently and satisfactorily?

This Article attempts to answer these and other questions about the issue of selecting a remedy in defective construction contract cases. Part I reviews recent case law to determine the standard courts use in these cases and how they apply that standard. Part II critiques the courts' performance. It suggests that the current rule permits too much discretion, allowing courts to reject the remedy of completion cost based on their own unarticulated subjective evaluation of the harm. This, in turn, results in inconsistent holdings and, frequently, undercompensation of the owner. Part III argues that although the uncertainties and subjectivity of the current rule adversely affect economic efficiency, other rules do not clearly produce more efficient results. In a search for alternatives, Part IV compares the results in contract cases with those obtained in tort cases that raise similar issues regarding choice of remedy. Finally, Part V suggests an alternative approach for selecting damages in construction contract cases: First, courts should award cost to complete whenever the owner intends to use the award to complete the contract, unless such an award would have an unreasonably harsh impact on the contractor. Second, in any case in which courts do not award cost to complete, they should award damages that approximate the actual loss in value to the owner — as tort cases do — without limiting recovery to the diminution in market value. This proposed standard would improve the current rule by increasing certainty of outcome, reducing the risks of undercompensation, and controlling more closely the manner in which courts exercise their discretion to reject cost to complete damages.

I. THE CHOICE OF REMEDY IN CONSTRUCTION CONTRACT CASES

When choosing a remedy, a court aims primarily to compensate the injured party adequately — to place her in as good a position as if the contract had been performed[24] — while

24. *See* RESTATEMENT (SECOND) OF CONTRACTS § 344(a) (1979).

avoiding overcompensation.[25] With this purpose in mind, the *Jacob & Youngs* court proposed a rule awarding the cost to complete the promised construction work unless that cost would be "grossly and unfairly out of proportion to the good to be attained."[26] In so doing, Judge Cardozo relied primarily on cases establishing the doctrine of substantial performance, which permits a contractor to recover in contract, even for defective performance, if the defects are of trivial or of inappreciable importance and affect the value of the building only slightly, and the breach is not made in bad faith or through gross negligence.[27] Courts developed the rule of substantial performance "as an instrument of justice," he said, and the measure of damages should be "shaped to the same end."[28] Other courts grappling with the same problem suggested that courts should award cost to complete unless remedying the defects would require "great" or "unreasonable" expense,[29] or material destruction of other parts of the structure.[30]

The *Restatement (First) of Contracts*, promulgated in 1932, offered a slightly different articulation. As in *Jacob & Youngs*, the *Restatement (First)* chose "reasonable cost to complete" as the primary measure of damages. That measure, however, would be available only if completion in accordance with the

25. One reason to avoid overcompensation is to prevent the unfairness that may occur if the breaching party is forced to pay more than necessary to compensate the injured party fully. Overcompensation may also discourage the other party to the contract from breaching when it is economically efficient to do so. *See* R. POSNER, ECONOMIC ANALYSIS OF LAW 116 (3d ed. 1986).

26. *Jacob & Youngs*, 230 N.Y. at 244, 129 N.E. at 891.

27. *Id.* at 244-45, 129 N.E. at 891-92.

28. *Id.* at 245, 129 N.E. at 892. The Washington Supreme Court has suggested that courts of that state initially tied choice of remedy directly to substantial performance: If the contractor had substantially performed, the court would award cost to remedy the defect; if there was no substantial performance, the injured party would receive only diminution in market value. Later, substantial performance was combined with the concept of economic waste, but the two doctrines were often viewed as flip sides of the same concept. Eastlake Constr. Co. v. Hess, 102 Wash. 2d 30, 44, 686 P.2d 465, 472 (1984) (en banc).

29. *See, e.g.*, J.E. Hollingsworth & Co. v. Leachville Special School Dist., 157 Ark. 430, 443, 249 S.W. 24, 27 (1923); Trunk & Gordon v. Clark, 163 Iowa 620, 625, 145 N.W. 277, 279 (1914); Pelatowski v. Black, 213 Mass. 428, 430, 100 N.E. 831, 832 (1913); Otis Elevator Co. v. Flanders Realty Co., 244 Pa. 186, 191, 90 A. 624, 626 (1914).

30. *See, e.g.*, Morris v. Fox, 79 Ind. App. 389, 394, 135 N.E. 663, 665 (1922); Gutov v. Clark, 190 Mich. 381, 387, 157 N.W. 49, 51 (1916); Graham v. Anderson, 121 Neb. 733, 735, 238 N.W. 362, 363-64 (1931); Burmeister v. Wolfgram, 175 Wis. 506, 512, 185 N.W. 517, 520 (1921); Foeller v. Heintz, 137 Wis. 169, 181, 118 N.W. 543, 548 (1908).

contract was possible and would not involve "unreasonable economic waste."[31] Although the terminology was new, the concept was consistent with the earlier case law. The comments to section 346 of the *Restatement (First)* suggest that economic waste would result if the finished product had a value much less than the cost of producing it, or if the defects could not be remedied "without tearing down and rebuilding, at a cost that would be imprudent and unreasonable."[32]

The *Restatement (Second) of Contracts*, issued in 1979, reformulated the standard. The *Restatement (Second)* begins with the premise that the injured party is entitled to the "loss in the value to him of the other party's performance" — the difference between the value of the performance as promised and the value as rendered.[33] The comment notes that, "in principle," this rule refers to the value of the breach to the particular injured party rather than to its value in the marketplace.[34]

Under section 348 of the *Restatement (Second)*, however, if the owner fails to prove the individualized loss in value with sufficient certainty, the owner may instead recover the reasonable cost of completing performance, but only if that cost is "not clearly disproportionate to the probable loss in value."[35] If the cost to complete *is* disproportionate, the owner will receive the diminution in market price that the breach caused.[36] The comment to section 348 explicitly rejects as misleading the *Restatement (First)*'s use of the term "economic waste," because an owner who receives more in damages than the actual "loss in value" ordinarily will not use the money to perform the

31. RESTATEMENT (FIRST) OF CONTRACTS § 346(1)(a)(i) (1932). The term "economic waste" had not previously been used in connection with cases of this kind. Before its use in the *Restatement (First)*, the term principally appeared in public utilities regulation cases, where courts often suggested that competition among utilities would result in "economic waste." *See, e.g.*, State v. Public Serv. Comm'n, 324 Mo. 270, 276, 23 S.W.2d 115, 117 (1929); Village of Northfield v. Public Util. Comm'n, 100 Ohio St. 424, 429, 126 N.E. 311, 313 (1919); York Haven Water & Power Co. v. Public Serv. Comm'n, 287 Pa. 241, 245, 134 A. 419, 420 (1926). In these cases, it seems to refer to unwise use of resources.

32. RESTATEMENT (FIRST) OF CONTRACTS § 346 (1932) comment on subsection (1a).

33. RESTATEMENT (SECOND) OF CONTRACTS § 347(a) (1979). The *Restatement (Second)* articulation is virtually identical to the views of E. Allan Farnsworth, the reporter for the *Restatement (Second)*, as he expressed them in his 1970 article on remedies. *See* Farnsworth, *supra* note 1.

34. RESTATEMENT (SECOND) OF CONTRACTS § 347 comment b (1979).

35. *Id.* § 348(2). Again, it is the individualized loss in value to the particular owner that is to be considered. *See supra* text accompanying note 34.

36. RESTATEMENT (SECOND) OF CONTRACTS § 348(2) (1979).

repairs.[37]

Under the *Restatement (Second)*, the determination of "loss in value" to the particular owner is crucial. If proved "with sufficient certainty," it is the primary measure of recovery and the yardstick against which to measure completion cost to determine whether such costs are recoverable. In theory, at least, the *Restatement (Second)* thus represents a marked departure from the approach of the *Restatement (First)*, which assumed cost to complete would be the remedy, unless cost to complete would produce "economic waste."

A review of recent case law makes clear, however, that courts continue largely to reflect the terminology and analysis suggested in the *Restatement (First)*.[38] Courts do not explore

37. *Id.* § 348(2) comment c. If the owner does not actually make the repairs, there will be no "waste" of resources. A court's concept of economic waste is distinct from the idea of economic efficiency. Although completion might, in a court's view, be "economically wasteful" — a bad use of resources — it would not be inefficient. *See infra* text accompanying notes 92-97.

38. One exception to this is the case of Eastlake Constr. Co. v. Hess, 102 Wash. 2d 30, 686 P.2d 465 (1984) (en banc), *aff'g in part and rev'g in part* 33 Wash. App. 378, 655 P.2d 1160 (1982). The owner of a five-unit apartment building sued the builder, claiming a variety of defects, including the installation of the wrong kind of kitchen cabinets. 33 Wash. App. at 379-80, 655 P.2d at 1162-63. The trial court found that removing and replacing the cabinets, at a cost of $11,634 for the new cabinets and $4,060 to remove the old ones, would constitute economic waste. The trial court therefore awarded only the difference in materials cost between the two types of cabinets. *Id.* The intermediate court of appeals reversed, holding that replacement of the cabinets would *not* constitute economic waste. 33 Wash. App. at 385, 655 P.2d at 1164. On appeal, the Washington Supreme Court conducted an extensive review of the history of Washington courts' remedy selection in defective construction cases, found the concept of economic waste confusing, and explicitly adopted the new approach of the *Restatement (Second)* as representing a "sensible and workable approach" to measuring damages. 102 Wash. 2d at 48, 686 P.2d at 475. The court then remanded for a redetermination of damages for the installation of the wrong kitchen cabinets. *Id.*

Just how courts would apply the *Restatement (Second)* standard remained unresolved, however. There was no trial after remand because defendant Eastlake was, by then, defunct for all practical purposes. Letter from R.M. Holt, attorney for Eastlake, to Prof. Carol Chomsky (Oct. 27, 1989) (on file with author). In a subsequent case, however, the Washington Court of Appeals interpreted *Eastlake* to mean that a court should award the lesser of diminution in market value and cost to complete, thereby failing to reflect the change in standard suggested by the *Restatement (Second)*. *See* Lyall v. DeYoung, 42 Wash. App. 252, 260, 711 P.2d 356, 360-61 (1985), *review denied*, 105 Wash. 2d 1009 (1986). Other courts similarly cite the *Restatement (Second)* provision, but only for the proposition that an award of cost to complete is inappropriate if disproportionate to loss in market value. *See, e.g.*, Kenney v. Medlin Constr. & Realty Co., 68 N.C. App. 339, 344-45, 315 S.E.2d 311, 314-15 (Ct. App.), *review denied*, 312 N.C. 83, 321 S.E.2d 896 (1984).

the individualized loss in value to the owner, but begin with the notion that the best measure of damages is usually the cost to complete the promised performance:[39] If the owner receives in damages the amount needed to purchase from another the performance for which she contracted, she will best be able to get the "benefit of the bargain" — the fulfillment of the promised performance. In most cases, the starting point is also the ending point: the court awards cost to complete as the measure of damages for the breach. When a court rejects cost to complete and chooses instead to award diminution in market value, it almost invariably asserts that granting cost to complete would result in economic waste.[40]

Although courts rarely attempt to define the phrase "economic waste," they seem to mean that, under the circumstances presented, completing performance would be a wasteful or unwise use of resources.[41] In some of the cases, waste would result because the price of completing the work would not result in a comparable increase in market value of the property.[42] In

39. Specific performance would also provide full compensation by mandating the contractor's actual performance of the contract obligations. Several commentators have suggested that specific performance should be more widely available and that it may provide the most efficient solution. *See, e.g.*, Linzer, *On the Amorality of Contract Remedies — Efficiency, Equity, and the Second Restatement*, 81 COLUM. L. REV. 111, 131-39 (1981); Schwartz, *The Case for Specific Performance*, 89 YALE L.J. 271, 278-96 (1979). Others disagree. *See* Yorio, *In Defense of Money Damages for Breach of Contract*, 82 COLUM. L. REV. 1365, 1398-1404 (1982). Although courts may be growing less reluctant to award specific performance in construction contracts, *see* Linzer, *supra*, at 126-27, specific performance continues to be a rarely requested or awarded remedy.

40. *See infra* notes 42-44.

41. *See, e.g.*, City of Anderson v. Salling Concrete Corp., 411 N.E.2d 728, 729-34 (Ind. Ct. App. 1980) (economically wasteful to require city to put $600,000 into the ground to level land as it promised, because property when levelled would be worth only $271,800). The courts' use of the term "economic waste" seems consistent with the way in which courts used it before its appearance in the *Restatement (First) of Contracts*. *See supra* note 31.

42. In these cases, the court focuses on the disproportion between cost to complete and diminution in fair market value. For example, in *Salem Towne Apartments, Inc. v. McDaniel & Sons Roofing Co.*, the court compared the $14,000 to $25,000 cost to replace discolored roofing tile on apartment buildings with the $7,500 diminution in market value. 330 F. Supp. 906, 910-14 (E.D.N.C. 1970); *accord* Thomas v. Schmidt, 58 Or. App. 343, 345-46, 648 P.2d 376, 376-77 (1982) (award of $2,160 to replace discolored roof tiles is disproportionate to $325 diminution in value and would constitute economic waste). In *City of Anderson v. Salling Concrete Corp.*, the evidence showed a cost of $590,731 to complete a landfill contract that would add only $180,000 to the market value of the land. 411 N.E.2d 728, 731-34 (Ind. Ct. App. 1980). Similarly, in *Witty v. C. Casey Homes, Inc.*, the court determined that the $50,000 cost of substituting

others, completion would be "wasteful" because it would require substantial undoing of otherwise satisfactory work.[43]

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the face brick originally ordered for the ordinary brick actually used would be disproportionate to the "results obtained," presumably the loss in market value. 102 Ill. App. 3d 619, 623-24, 430 N.E.2d 191, 194-95 (1981). In each of these cases, after first noting the disproportion, the court concluded that to award cost to complete would constitute economic waste.

As noted in the comment to § 348 of the *Restatement (Second) of Contracts*, however, such economic waste will occur only if the owner actually undertakes the work required to complete performance. *See supra* note 37 and accompanying text. In many cases, courts may believe that the owner will *not* do the work and will simply pocket the damage award, resulting in what they perceive as a windfall. *See infra* note 56 and accompanying text.

As a guide to disproportion, a few courts have used the contract price or the market value of the property rather than the diminution in market value. When they do so, they have usually concluded that completion would not be wasteful because cost to complete is not disproportional to the value of the entire contract or property. *E.g.*, Beik v. American Plaza Co., 280 Or. 547, 555-56, 572 P.2d 305, 310 (1977) ($8,700 cost to repair not disproportionate to $40,000 purchase price); Rhode Island Turnpike & Bridge Auth. v. Bethlehem Steel Corp., 379 A.2d 344, 356 (R.I. 1977) ($4.5 million cost to repaint bridge not grossly disproportionate to $19 million price for building Newport Bridge); *see, e.g.*, Schmauch v. Johnston, 274 Or. 441, 444-46, 547 P.2d 119, 120-22 (1976) ($6,290 cost to repair not disproportionate to $57,344 cost of house). *See infra* note 128 and accompanying text (in torts cases, some courts award cost to repair unless greater than market value of whole property).

43. *E.g.*, Grossman Holdings, Ltd. v. Hourihan, 414 So. 2d 1037, 1038-39 (Fla. 1982) (reorienting direction of house to gain promised southeastern exposure would require substantially rebuilding home), *remanding* 396 So. 2d 753 (Fla. Dist. Ct. App. 1981); Witty v. C. Casey Homes, Inc., 102 Ill. App. 3d 619, 623-24, 430 N.E.2d 191, 194-95 (1981) (replacement of brick facing would require removal of wood trim and repair to doors, door frames, window frames, and sliding glass doors that would be damaged from brick replacement); Classic Builders, Inc. v. Lies, 766 P.2d 1297 (decision published without opinion), No. 61,861 (Kan. Ct. App. Dec. 22, 1988) (Westlaw) (repair of defect — building one corner of house two inches higher than the other corners — would require substantially destroying and rebuilding house); Jacob & Youngs, Inc. v. Kent, 230 N.Y. 239, 242-45, 129 N.E. 889, 891-92 (1921) (replacement of pipe would require tearing down and rebuilding walls); Subsurfco, Inc. v. B-Y Water Dist., 337 N.W.2d 448, 454-55 (S.D. 1983) (repair of defective 37 miles of 614-mile water distribution system would require reconstructing substantial portion of project); Plante v. Jacobs, 10 Wis. 2d 567, 569, 573-74, 103 N.W.2d 296, 297-99 (1960) (fixing misplaced living room wall would require tearing down and rebuilding, involving destruction and also damage to other rooms).

In most of these cases, the court also relies upon the disproportion between cost to complete and diminution in market value. *See, e.g., Grossman Holdings*, 414 So. 2d at 1038, 1040 (cost to reposition house out of proportion to good that would be attained); *Witty*, 102 Ill. App. 3d at 623, 430 N.E.2d at 194 (cost of repairs grossly disproportionate to result of substituting face brick veneer for ordinary brick); *Classic Builders*, No. 61,861 (Westlaw) ($94,000 cost to lower raised corner of house adjudged too high); *Jacob & Youngs*, 230 N.Y. at 244, 129 N.E. at 891 (use of alternative brand of pipe would have no effect on value of the home). *But see* Groves v. John Wunder Co., 205 Minn. 163, 168,

Despite the existence of factors suggesting the wastefulness of completing the contract, courts have declined to find economic waste when they recognize that aesthetic values make completion particularly important to the owner.[44] For example, in *Gory Associated Industries, Inc. v. Jupiter Roofing & Sheet Metal, Inc.*,[45] the court awarded $11,250 to replace faded and discolored roof tiles because the condominium owners were entitled to receive the aesthetically pleasing roof they were promised. In *City School District of Elmira v. McLane Con-*

286 N.W. 235, 238 (1939) (waste "has nothing to do with the value in money of . . . the product of the contract" but refers only to wrecking a physical structure).

Courts have permitted awards of cost to complete despite substantial destruction of completed work when they have found the destruction and repair necessary to make a building or facility usable. *E.g.*, Worthen Bank & Trust Co. v. Silvercool Serv. Co., 687 P.2d 464, 465-67 (Colo. Ct. App. 1984) (roof on commercial building unusable; replacement warranted though cost three times original contract price); Sanborn Elec. Co. v. Bloomington Athletic Club, 433 N.E.2d 81, 88-90 (Ind. Ct. App. 1982) (court permitted award that contemplated dismantling and rebuilding of poorly joined racquetball court walls in order to provide usable facility); English Village Properties, Inc. v. Boettcher & Lieurance Constr. Co., 7 Kan. App. 2d 307, 310, 316-17, 640 P.2d 1282, 1286, 1290, *rev. denied*, 231 Kan. 799 (1982) (court awarded cost to repair defectively constructed motel, even though it would require tearing out and then restoring wallpaper, sheetrock, and insulation, because motel rooms were uninhabitable until moisture retention problem fixed). In such cases, courts often do not refer expressly to the diminution in market value. It seems likely, however, that, because the repairs or completion are necessary in order to make the property usable, the market value would directly reflect the cost of the necessary work so there would be no disproportion between cost to complete and diminution in market value. *See also* Hebert v. McDaniel, 479 So. 2d 1029, 1034 (La. Ct. App. 1985) (defects in construction of roof were such that entire roof needed replacing to cure leak and make building usable); Emery v. Caledonia Sand & Gravel Co., 117 N.H. 441, 446-48, 374 A.2d 929, 933 (1977) (damages to eliminate pit on land and restore the land to original condition are appropriate because without such restoration land has been rendered unproductive); Kenney v. Medlin Constr. & Realty Co., 68 N.C. App. 339, 344, 315 S.E.2d 311, 314-15 (1984) (cost to repair foundation so defective that it does not meet building standards is not so "disproportionately high as compared to the loss in value without such repair"); Prier v. Refrigeration Eng'g Co., 74 Wash. 2d 25, 28-29, 442 P.2d 621, 624 (1968) (defects in construction made ice rink unusable; court awarded total reconstruction cost to erect a working ice rink).

44. *See, e.g.*, Fox v. Webb, 268 Ala. 111, 119, 105 So. 2d 75, 82 (1958) ("when an owner contracts to have a dwelling constructed he wants a particular structure, not just any structure that could be built for the same price"). In some cases, the court's recognition of aesthetic values may lead it to conclude that there is no disproportion between cost to complete and diminution in value. *See* Rhode Island Turnpike & Bridge Auth. v. Bethlehem Steel Corp., 119 R.I. 141, 155-56, 379 A.2d 344, 356-57 (1977) (court awarded $4.5 million to repaint graceful Newport bridge because not economic waste; determination of diminution in value would be "unconscionable speculation").

45. 358 So. 2d 93, 94-95 (Fla. Dist. Ct. App. 1978).

struction Co.,[46] the court awarded $357,000 to replace discolored beams in the ceiling of a swimming pool, although the diminution in value may have been only $3,000, because the aesthetics of the natural wood roof were critical for the planned architectural showcase. In *Advanced, Inc. v. Wilks*,[47] the court upheld a jury award of $150,402 to repair an elliptical, earth-sheltered concrete house that would have an approximate value of $114,000 if built without defects. In another case, *Fairway Builders, Inc. v. Malouf Towers Rental Co.*,[48] the court awarded $59,813 to replace defective marblecrete on the exterior of an office building, which required tearing down the walls to the studs, because the owner reasonably wanted the building, located on Main Street, to have the desired appearance.[49]

Court recognition of the special value of completion is not automatic, however. In some cases where personal values seem significant, courts have not discussed them or have not consid-

46. 85 A.D.2d 749, 750, 445 N.Y.S.2d 258, 260-61 (1981).

47. 711 P.2d 524, 525-27 (Alaska 1985).

48. 124 Ariz. 242, 251-55, 603 P.2d 513, 522-25 (Ct. App. 1979).

49. In a few of the cases recognizing personal value to the owner exceeding the diminution in fair market value, the owner had given explicit notice to the contractor that the specification at issue was especially important. In Edenfield v. Woodlawn Manor, Inc., 62 Tenn. App. 280, 284-86, 462 S.W.2d 237, 240-42 (1970), for example, plaintiff's husband, an electrical engineer and contractor, rejected the contract as originally drafted and placed into it a clause requiring that all construction was to be done "in strict accordance" with the specifications. When the builder used air conditioning ducts that were shaped differently and produced a lower capacity airflow than specified in the contract, the court awarded $11,099 to replace them, even though the work would require destroying and replacing walls, and the amount awarded might far exceed the market value difference. In Kangas v. Trust, 110 Ill. App. 3d 876, 877-81, 441 N.E.2d 1271, 1273-76 (1982), the plaintiff had pointed out to the contractor the high basement ceiling in her previous home when specifying the way in which she wanted the basement in her new home constructed. When the contractor built the basement four inches too short, the court awarded $20,000 to lower the basement floor, though the diminution in market value was much less. In *Kangas*, though not in *Edenfield*, the court placed particular emphasis on the notice given. *Kangas* is particularly unusual because the plaintiff had apparently sold the home before trial. *Id.* at 879, 441 N.E.2d at 1274. Her individual valuation of contract performance was no longer an issue, since she intended neither to lower the basement floor nor to live in the defective home while suffering damage to her aesthetic sensibilities. *Contra* Hoagland v. Celebrity Homes, Inc., 40 Colo. App. 215, 217, 572 P.2d 493, 494 (1977) (measure of damages is cost to repair if owner retains property, diminution in market value if property already sold). The court in *Kangas* may have determined that the contractor should pay the higher measure of damages, despite the subsequent sale, because it willfully breached the contract. *See also* American Standard, Inc. v. Schectman, 80 A.D.2d 318, 321-25, 439 N.Y.S.2d 529, 531-34 (1981).

ered them important enough to overcome the disproportion.[50] In *Grossman Holdings, Ltd. v. Hourihan*,[51] for example, the court awarded no damages because the failure to build a house with the promised southeastern exposure did not affect its market value. In *Witty v. C. Casey Homes, Inc.*,[52] the court awarded diminution in market value when the contractor substituted common brick for higher quality face brick veneer without discussing the owner's aesthetic choice. And, in *Marshall v. Marvin H. Anderson Construction Co.*,[53] the court awarded diminution in market value caused by repeated damage to walls and wallpaper resulting from faulty ventilation in the roof.

In addition to their primary focus on economic waste, courts sometimes consider other circumstances that may influence, though not control, their choice of damages. A few cases refer to the willful or deliberate nature of the contractor's breach.[54] Others consider whether the breached contract term

50. In addition to the cases discussed at *infra* notes 51-53, see, *e.g.*, Salem Towne Apartments, Inc. v. McDaniel & Sons Roofing Co., 330 F. Supp. 906, 912-14 (E.D.N.C. 1970) (discolored roofing tile on 16 apartment buildings); Lowe v. Morrison, 412 So. 2d 1212, 1213 (Ala. 1982) (floors not level, walls not plumb, roof poorly constructed, and many other aspects defective or unsightly); Pence v. Dennie, 41 Cal. App. 428, 430, 182 P. 980, 982 (1919) (brick substituted for artificial stone on facade); Thomas v. Schmidt, 58 Or. App. 343, 345-46, 648 P.2d 376, 376-77 (1982) (discolored roofing tile); Plante v. Jacobs, 10 Wis. 2d 567, 573-74, 103 N.W.2d 296, 297-99 (1960) (misplacement of living room wall). In some of these cases, the nature of the special interest in completion was identical to that deemed sufficient in other cases. For example, compare Witty v. C. Casey Homes, 102 Ill. App. 3d 691, 623-24, 430 N.E.2d 191, 194-95 (1981), with Fairway Builders, Inc. v. Malouf Towers Rental Co., 124 Ariz. 242, 245) 303 P.2d 513, 515-16 (1979), where incorrect exteriors were installed, and Salem Towne Apartments, Inc. v. McDaniel & Sons Roofing Co., 330 F. Supp. 906, 912-14 (E.D.N.C. 1970), with Gory Associated Indus., Inc. v. Jupiter Roofing & Sheet Metal, Inc., 358 So. 2d 93, 95 (Fla. Dist. Ct. App. 1978), where discolored roofing tile was installed.

51. 414 So. 2d 1037, 1038-39 (Fla. 1982), *remanding* 396 So. 2d 753 (Fla. Ct. App. 1981).

52. 102 Ill. App. 3d 691, 623-24, 430 N.E.2d 191, 194-95 (1981).

53. 283 Minn. 320, 324-25, 167 N.W.2d 724, 728 (1969).

54. Some of these cases grant disproportionately high cost to complete even though the owner did not demonstrate any special personal value in completion. *See* Groves v. John Wunder Co., 205 Minn. 163, 165-67, 286 N.W. 235, 236-38 (1939) (defendant lessee promised to regrade land after removing sand and gravel but willfully and in bad faith refused to perform after removing "only 'the richest and best of the gravel;' " court awarded $60,000 cost to complete though land worth only $12,160); American Standard, Inc. v. Schectman, 80 A.D.2d 318, 321-25, 439 N.Y.S.2d 529, 531-34 (1981) (defendant lessee promised to remove subsurface structures and regrade land but did not perform in

was central or incidental to the purpose of the contract.[55] Some courts express concern that the owner who is awarded a disproportionately high cost to complete will not use it to perform the work, but will instead pocket the money and thereby receive a windfall.[56]

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good faith; court awarded $90,000 cost to complete though diminution in market value, as reflected in actual sale was only $3,000).

In others, the willfulness was mentioned but did not appear to be a major factor in the court's decision to grant cost to complete as a remedy. *See* Henderson v. Oakes-Waterman Builders, 44 Cal. App. 2d 615, 616-19, 112 P.2d 662, 663-65 (1941) (contractor willfully violated terms of contract; court awarded $3,702 to repair defects on original contract of $2,500 because structure untenantable and useless); Kangas v. Trust, 110 Ill. App. 3d 876, 877-80, 441 N.E.2d 1271, 1273-77 (1982) (contractor willfully disregarded owner's specification of ceiling height; court awarded $20,000 to lower basement floor, though amount greatly exceeded diminution in value, because owner's personal aesthetics offended); Bellizzi v. Huntley Estates, Inc., 3 N.Y.2d 112, 114-15, 143 N.E.2d 802, 803-04, 164 N.Y.S.2d 395, 396-97 (1957) (court awarded cost to repair driveway made unsafe and unusable by 22% grade in part because contractor, in order to save costs, did not excavate unforeseen rock); Beik v. American Plaza Co., 280 Or. 547, 555-56, 572 P.2d 305, 310 (1977) (contractor willfully breached, installing inferior materials to save a total of $65,000 for all condominium units; court awarded $8,700 per-unit cost to repair defects in windows, sliding glass doors, and air conditioner units in luxury condominiums because not disproportionate to the $40,000 per-unit purchase price).

In one case, however, the deliberate nature of the contractor's breach was insufficient to overcome the court's determination that awarding cost to complete would result in economic waste. *See* Grossman Holdings, Ltd. v. Hourihan, 414 So. 2d 1037, 1038-39 (Fla. 1982) (contractor built home contrary to specifications of southeastern exposure; though contractor acted willfully in ignoring homeowner's complaints, court limits damages to diminution in market value), *remanding* 396 So. 2d 753 (Fla. Dist. Ct. App. 1981); *cf.* Pence v. Dennie, 41 Cal. App. 428, 433-34, 182 P. 980, 982 (1919) (court declines to award cost to replace brick with artificial stone required in contract; contractor may not have acted deliberately or willfully).

55. *See, e.g., American Standard*, 80 A.D.2d at 321-25, 439 N.Y.S.2d at 531-34 (contract provision not incidental to the main contract purpose); Peevyhouse v. Garland Coal & Mining Co., 382 P.2d 109, 112-14 (Okla. 1962) (contract provision incidental), *cert. denied*, 375 U.S. 906 (1963); Edenfield v. Woodlawn Manor, Inc., 462 S.W.2d 237, 240-42 (Tenn. Ct. App. 1970) (contract provision not incidental). In Hitchcock v. Peter Kiewit & Sons Co., 479 F.2d 1257, 1259 (10th Cir. 1973), the court held that the jury must be allowed to decide whether the breached contract provision was incidental to the main purpose of the contract.

When a court decides that the breached term is incidental, as the Oklahoma Supreme Court did in *Peevyhouse*, it seems in effect to be determining that the owner's desire for completion is not sufficiently important to warrant relief, given the disproportion between cost to complete and the price of the contract. Thus, the question whether the term is incidental is simply an alternative articulation of the same issue faced in all the cases.

56. *See, e.g.*, County of Maricopa v. Walsh & Oberg Architects, Inc., 16 Ariz. App. 439, 442, 494 P.2d 44, 46-47 (1972) (court declined to award the $350,710 or $498,169 estimated cost to repair defectively built underground

But, as in the *Restatement (First)*, the court's primary focus remains the inquiry whether the cost of completion — the preferred remedy — would constitute an unwise use of resources, an economic waste. The *Restatement (Second)*, which purports to focus on the value of contract performance to the owner, has affected their analyses only minimally.

II. ADEQUATE COMPENSATION AND THE EFFECT OF PERSONAL VALUES

Parties entering construction contracts seem rarely to include a provision selecting a measure of damages. Courts are therefore forced to fill this gap in the agreed terms. As in other instances in which a court must supply omitted terms, courts might take one of several approaches.

Courts may attempt to choose a remedy based on the actual expectations of one or both of the parties, even though the contract did not define these expectations. If the parties shared the same expectation, courts should adopt the remedy that both parties thought would apply.[57] If the expectations differed, courts should adopt the remedy one party expected, as long as the other party knew or should reasonably have known of the expectation at the time of contract formation.

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parking garage, questioning county's commitment to performing the extensive relandscaping required); City of Anderson v. Salling Concrete Corp., 411 N.E.2d 728, 731-34 (Ind. Ct. App. 1981) (court rejected award of $600,000 to complete landfill contract, suggesting plaintiff would receive windfall of $420,000 over property's value of $180,000); *cf.* Realty Assocs. v. United States 138 F. Supp. 875, 877 (Ct. Cl. 1956) (lessor did not really want restoration costing $220,000, as promised in lease, as such work would return building, currently fully leased, to "ancient, inaccessible and largely unusable" condition).

Even if not expressed, concern that the owner will receive a windfall may be the real basis for denying cost to complete as economically wasteful. "Waste" occurs only if the work is done. When they see a substantial difference between cost to complete and diminution in market value, courts may not expect the plaintiffs actually to undertake the completion work. *See, e.g.*, Rands v. Forest Lake Lumber Mart, Inc., 402 N.W.2d 565, 566-67 (Minn. Ct. App. 1987) (walls not plumb, unusual bounce to living room floor; $56,350 cost to repair not awarded because prudent investor would not perform repairs when diminution in value only $18,600).

57. The objective theory of contract interpretation suggests, in its strictest form, that only intentions manifested to the other party should be considered part of the agreement. The better view, however, and the one most commentators and courts have adopted, is that the actual intention of the parties should prevail, even if that is not reflected in any objective manifestations. *See, e.g.*, 3 A. CORBIN, CORBIN ON CONTRACTS § 539 (1964); 2 E.A. FARNSWORTH, CONTRACTS § 7.9 (2d ed. 1990) (cases cited therein); RESTATEMENT (SECOND) OF CONTRACTS § 201(1) (1979).

The difficulty with basing a selection of remedy upon the actual expectations of the parties is that expectations not defined in the contract may be difficult or impossible to determine. There may be little or no evidence of what the parties expected, other than their own testimony about their unarticulated assumptions at the time they entered the contract. Moreover, in many cases it is likely that neither party thought about the extent to which the contractor would be liable for completion costs after defective performance. At best, contractors may have an understanding, and therefore an expectation, that they have a limited responsibility to pay damages in an amount needed to complete the work as promised. In contrast, most owners are likely to believe that they are entitled to the promised particulars, including, implicitly, an award of money sufficient to pay a third party to complete that performance if the contractor fails to do so. These generalized expectations provide little basis either to find that the parties agreed on a remedy principle or that either party agreed to the other's understanding.

In most cases, then, when the parties entered their contract, they will have had no actual or specific expectations regarding the available remedy for breach, or courts will be unable to determine those expectations satisfactorily. Under these circumstances, courts might adopt a second approach, selecting as a measure of damages what the parties would have chosen *had* they thought about it. Some commentators have argued that doing so will produce the most efficient result, saving the costs associated with negotiation, yet reaching the same result as if the parties had negotiated the issue.[58] Others have suggested that choosing a remedy that the parties would *not* likely adopt may be more efficient because it will encourage parties in future contracts to share information, to choose their own contract terms, and to save the transaction costs associated with court determination after breach.[59] In any event, determining post-breach what the parties would have chosen as the damages remedy had they considered the issue in the negotiations stage seems virtually impossible. At best, courts can attempt to determine, not what particular parties would have

58. *See, e.g.*, R. POSNER, *supra* note 25, at 107; Baird & Jackson, *Fraudulent Conveyance Law and Its Proper Domain*, 38 VAND. L. REV. 829, 835-36 (1985); Goetz & Scott, *The Mitigation Principle: Toward a General Theory of Contractual Obligation*, 69 VA. L. REV. 967, 971 (1983).

59. *See* Ayres & Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 91-93 (1989); *infra* note 112.

chosen as a remedy, but what hypothetical reasonable parties would likely select as a remedy.

Perhaps because of the difficulty of determining either the actual or hypothetical expectations of the particular parties to the contract, courts have generally followed this last path, simply selecting what they consider the "reasonable" or "just" solution. The general rule — granting cost to complete unless such an award would constitute economic waste — attempts to balance the owner's interests in completion of the contract performance with the contractor's interest in avoiding paying overcompensatory damages. It does so, however, in a fashion that injects the subjective values of the factfinder (whether judge or jury) into the calculation of damages, thereby causing inconsistent judgments about remedies and sometimes discounting or ignoring the particular value the owner places on contract performance.

Courts rejecting cost to complete as constituting economic waste seem to base their decision on two interrelated premises: First, granting cost of completion would over-compensate the owner because the lower diminution in market value more accurately establishes the harm from the breach. Second, expenditure of cost to complete would be an unreasonable use of resources. Instead of using the owner's valuation of the injury caused by breach, both of these premises substitute the factfinder's judgment of the worth of contract performance.

Courts rejecting awards of completion cost as economically wasteful base their decisions on the disproportion between cost to complete and diminution in market value. Use of market value as a yardstick in these cases is problematic, however. The market, of course, represents consensus, not individual, values. When defective performance interferes with the functional utility of the constructed facility, buyers will usually consider correction of the defects necessary; thus, the diminution in market value will directly reflect the cost of the necessary repairs. When the defect involves more personal values, such as aesthetics or environmental consciousness, the market is unlikely to reflect the injury to the owner. Such breaches will not diminish the usefulness of the constructed facility and many potential buyers will not be concerned about that particular aspect of the property.[60] Here, the substitution of fair market

60. Another difficulty is the possibly limited accuracy of the estimates of the diminution of fair market value. Determining fair market value is a complex and inexact task. *See generally* AMERICAN INSTITUTE OF REAL ESTATE

value for cost to complete sacrifices the value choices of the owner to those of the marketplace. As a result, the owner is not fully compensated for the injury caused.[61] When the owner has an interest in full performance of the contract that a substantial number of possible buyers do not share, the diminution in market value cannot represent full compensation. Only where the owner holds the property for investment or sale will the owner's injury be commensurate with the effect of the contract breach on market value. Few of the cases fall in this category.[62] When the owner holds the property for use, not for sale, employing the market measure of damages amounts to a "forced sale:" it awards the amount the owner would be injured if the property were sold, even though the owner chooses not to sell.

However, award of diminution in market value is not automatic whenever the diminution is less than — even substantially less than — cost to complete. The disproportion is a necessary, but not a sufficient, condition. Rather, courts then determine if the expenditure of cost to complete would constitute economic waste. The decisionmaker will reject market damages if he believes that the expenditure of funds to complete the contract is justified.

APPRAISERS, THE APPRAISAL OF REAL ESTATE (8th ed. 1983) (explaining appraisal methods); A. RING & J. BOYKIN, THE VALUATION OF REAL ESTATE 58-64 (1986) (discussing factors used in assessing fair market value). The difficulties are likely to be compounded when the aim is to ascertain what the fair market value would have been if the property were in a different condition than it is presently. The cases themselves often reflect an extraordinary range of estimated values for fair market differential. *See, e.g.*, Salem Towne Apartments, Inc. v. McDaniel & Sons Roofing Co., 330 F. Supp. 906, 914 (E.D.N.C. 1970) (actual diminution in market value hard to establish); Orndorff v. Christiana Community Bldrs., 217 Cal. App. 3d 683, 685, 266 Cal. Rptr. 193, 197-98 (1990) (estimates ranging from $67,500 to $160,500 for value of property as built); Rands v. Forest Lake Lumber Mart, Inc., 402 N.W.2d 565, 569 (Minn. Ct. App. 1987) (estimates ranging from $56,000 to $800,000). This is true even when the failure to perform involves true defects in construction, when one would expect a decline in fair market value to be comparable to the amount that must be spent to effect necessary repairs. Even more uncertainty is likely when aesthetic judgments are involved, because it is more difficult to predict how potential buyers will evaluate the difference in value when subjective judgment is at stake.

61. *See* Farnsworth, *supra* note 1, at 1168; Muris, *Cost of Completion or Diminution in Market Value: The Relevance of Subjective Value*, 12 J. LEGAL STUD. 379, 387 (1983).

62. Indeed, an owner primarily concerned with investment value is less likely to sue because the expenses of prosecuting the lawsuit may exceed the diminution in market value, which is the actual measure of loss to such an owner. Muris, *supra* note 61, at 394.

We learn from the case law, for example, that having a bridge without chipped paint,[63] a showcase swimming pool with attractive ceiling beams,[64] a perfect brick veneer,[65] or the proper height basement ceilings[66] is valuable, and the owner should be compensated sufficiently to allow performance of the work specified in the contract. In contrast, having land restored to its previous contours after strip mining,[67] having a face brick exterior instead of one made of common brick,[68] having a usable grain storage facility,[69] or having a house with a southeast exposure[70] is not valuable enough to warrant an award of cost to complete, and the owner can receive only diminution in market value.

How do the factfinders reach these conclusions? The opinions are devoid of any explanation except the occasional reference to a suspicion that the owner does not intend to use the money to repair the breach.[71] In many cases, however, the decisionmaker appears simply to be making its own value choice, deciding whether the proposed use of resources is, in its opinion, reasonable. The injured party can obtain enforcement of the contract as written only if the factfinder agrees that the contract performance is important, or at least is willing to recognize the legitimacy of the owner's views about its importance.[72] As a result, individuals cannot enforce their private

63. Rhode Island Turnpike & Bridge Auth. v. Bethlehem Steel Corp., 119 R.I. 141, 162-69, 379 A.2d 344, 356-59 (1977).

64. City School Dist. of Elmira v. McLane Constr. Co., 85 A.D.2d 749, 749-51, 445 N.Y.S.2d 258, 259-61 (1981).

65. Carter v. Quick, 263 Ark. 202, 206-10, 563 S.W.2d 461, 463-66 (1978).

66. Kangas v. Trust, 110 Ill. App. 3d 876, 882-84, 441 N.E.2d 1271, 1275-77 (1982).

67. Peevyhouse v. Garland Coal & Mining Co., 382 P.2d 109, 114 (Okla. 1962), *cert. denied*, 375 U.S. 906 (1963). Of course, values may change over time, prompting a later court to reach an opposite conclusion. *See infra* note 74 and accompanying text.

68. Witty v. C. Casey Homes, Inc., 102 Ill. App. 3d 619, 623-24, 430 N.E.2d 191, 194-95 (1981).

69. Lesmeister v. Dilly, 330 N.W.2d 95, 102-03 (Minn. 1983). In *Lesmeister*, the plaintiff received $20,000 for diminution in value of a grain storage building constructed on his farm, but the building could not be used for grain storage without complete reconstruction at a far greater cost. *Id.* at 98-99.

70. Grossman Holdings, Ltd. v. Hourihan, 414 So. 2d 1037 (Fla. 1982), *remanding* 396 So. 2d 753 (Fla. Dist. Ct. App. 1981).

71. *See supra* note 56 and cases cited therein. In some cases, the owner acknowledges that the money will not be used to repair the breach; in others, the disproportion alone may have been sufficient to lead the court to conclude that the owner will pocket the damage award and leave the construction as is.

72. When a court chooses to allow only diminution in market value rather than cost to complete, the court arguably is still "enforcing" the contract. In-

contracting power to do things that others find unimportant.[73] Idiosyncratic individual preferences will lose to more traditional values or to the values of the individual judge or jury.

A few of the decided cases demonstrate the effect of giving the factfinder such open-ended discretion to decide the value of contract performance. *Peevyhouse* is, of course, a prime example of a case in which the plaintiffs got little relief for their injury because the judges' values and the values of the marketplace did not coincide with their own. *Peevyhouse* itself might be decided differently today because of heightened sensitivity to environmental concerns,[74] but the change in outcome

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deed, the rationale for choosing diminution in value is often that an award of diminution in value will enforce the rights of the complaining party by compensating for the injury caused, but that a grant of cost to complete would overcompensate. Nonetheless, if the court awards the lesser diminution in value, the owner will not be able to arrange for completion of the precise terms of the contract. Thus, the court, awarding what it believes to be the monetary equivalent of performance, enforces the contract, but the contract is not enforced "as written."

73. Even under current doctrine, a party presumably could ensure full compliance by inserting a clause selecting cost of completion as the required remedy for certain breaches. But owners generally assume they are protected adequately by including their desires as contract specifications, and the current standard is not designed to encourage contractors to inform them otherwise. *See infra* Part III.

74. *See* Rock Island Improvement Co. v. Helmerich & Payne, Inc., 698 F.2d 1075 (10th Cir.), *cert. denied*, 461 U.S. 944 (1983). This case is remarkably similar to *Peevyhouse*. Helmerich & Payne leased two tracts of land to the Rock Island Improvement Company for strip mining purposes and included in the contract a clause requiring Rock Island to restore the surface of the land to its condition prior to the mining operation. When mining was completed, Rock Island left the land unrestored. *Id.* at 1076-77. The evidence showed that the cost to restore the land would be $375,000 and that the loss in market value to the land because of the failure to restore was $6,797. *Id.* at 1077-78. Although the Tenth Circuit was applying Oklahoma law, and was therefore bound to consider *Peevyhouse* as binding precedent, the court upheld the jury's award of $375,000. *Id.* at 1082. The court concluded that, because Oklahoma statutes now require that certain land restoration be done regardless of cost, the Oklahoma Supreme Court would no longer apply the *Peevyhouse* rule to the same set of facts. *Id.* at 1078-79. The court thus acknowledged the critical importance that evaluation of the worth of the promised performance has in controlling the outcome of the case. *See also* Miller v. C.K.L., Inc., No. 88-CA-6 (Ohio Ct. App. Oct. 6, 1988) (Westlaw, 1988 WL 106637) (lessee mining company has responsibility to reclaim land pursuant to Ohio statutes even though lease contained no restoration requirement; trial court award of $334,824 to restore land was proper even if loss in market value much smaller). Whether a court would reach the same result in the absence of statutes is not clear, however. *See* Thompson v. Andover Oil Co., 691 P.2d 77, 83 (Okla. Ct. App. 1984) (surface owner can be awarded no more than depreciated value of land for injury caused by mining, citing *Peevyhouse*); *cf.* Ewell v. Petro Processors of Louisiana, Inc., 364 So. 2d 604, 609 (La. Ct. App.

based on shifting societal concerns highlights, not mutes, the effect of allowing the factfinder to impose its values on the plaintiff.

Several recent cases also demonstrate the intrusive role of courts' subjective valuation. In three cases — *Gory Associated Industries, Inc. v. Jupiter Roofing & Sheet Metal, Inc.*,[75] *Salem Towne Apartments, Inc. v. McDaniel & Sons Roofing Co.*,[76] and *Thomas v. Schmidt*[77] — the plaintiffs complained of discolored tiling in roofing jobs. In *Gory*, the plaintiffs did not receive the particular roof tile they had ordered, but replacing the incorrect tile would cost $11,250, fifty percent more than the original roofing contract price.[78] Here, the court supported the owner, calling him a "proud householder who plans to live out his days in the home of his dreams," and holding him entitled to the performance promised.[79] In contrast, the plaintiffs in *Salem Towne Apartments* and *Thomas* were limited to diminution in market value, though the courts then awarded diminution damages reflecting the aesthetic concerns of the owners or prospective purchasers.[80]

Sometimes the effect of differing judicial views about the worth of contract performance is displayed within a single case. In *Hourihan v. Grossman Holding, Ltd.*,[81] for example, the

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1978) (in tort action, diminution in market value awarded because cost to restore land polluted by hydrocarbons too high), *cert. denied*, 366 So. 2d 575 (La. 1979).

75. 358 So. 2d 93 (Fla. Dist. Ct. App. 1978).

76. 330 F. Supp. 906 (E.D.N.C. 1970).

77. 58 Or. App. 343, 648 P.2d 376 (Ct. App. 1982).

78. 358 So. 2d at 95 (original contract price was $7,070, but $11,250 was not disproportionate to value of whole house).

79. *Id.*

80. *Salem Towne Apartments*, 330 F. Supp. at 913-14 (judge inspected the property and awarded $7,500 instead of $14,000 to $25,000 cost to repair because "a question of aesthetics [is] involved and the roof might conceivably cause some minor concern to prospective buyers"); *Thomas*, 58 Or. App. at 345-46, 648 P.2d at 377 (court awarded $325 diminution instead of $2,160 cost to repair, "[r]ecognizing that beauty is somewhat subjective . . ."). In *Thomas*, the failure to award cost to complete may be explained by the fact that the trial court found the discoloration "barely visible," though sufficient to constitute a breach of contract. *Id.* The extent of discoloration in *Salem Towne Apartments* and *Gory* is not clear. In *Salem Towne Apartments*, the building with a discolored roof was an apartment complex of rental units. 906 F. Supp at 908. Because the owner held the property for commercial use, not personal occupancy, the use of diminution in market value seems proper. *See supra* note 62. The award of $7,500 based on aesthetics is questionable, however, since the evidence showed full occupancy and no reduction in rental values.

81. 396 So. 2d 753, 755-56 (Fla. Dist. Ct. App. 1981), *remanded*, 414 So. 2d 1037 (Fla. 1982).

trial court awarded the cost to rebuild completely a home that had been positioned incorrectly; on appeal, the Supreme Court of Florida found the expenditure to be economic waste, apparently rejecting as insufficient the owner's desire for a southeastern exposure.[82] In *Eastlake Construction Co. v. Hess*,[83] the trial court found it economically wasteful to replace the less-expensive kitchen cabinets the builder installed with the more expensive ones specified in the contract. The state court of appeals disagreed. In each of these cases, whether completion was considered to be economic waste seemed to depend on whether the factfinder valued performance as much as the plaintiffs did[84] — that is, whether the plaintiff's desire for complete performance was found to be reasonable. No court proposed any standards for making that determination.[85]

The use of the reasonableness test permits courts to override individual contractual choices and substitute their own

82. *Grossman Holdings*, 414 So. 2d at 1040. The owners had testified that they chose a home with southeastern exposure so it would be in line with prevailing sea breezes, and air conditioning would be unnecessary. 396 So. 2d at 754-55. Early in the construction, the owners visited the homesite and notified the builder of the incorrect positioning, but the builder refused to correct the problem. *Id.* at 754. The Florida Supreme Court did not refer to the owners' testimony in reaching its conclusion that completion would constitute economic waste.

83. 33 Wash. App. 378, 384, 655 P.2d 1160, 1164 (1982), *aff'd in part and rev'd in part*, 102 Wash. 2d 30, 686 P.2d 465 (1984) (en banc).

84. The same potential for imposing the factfinder's own values exists in tort cases. In Baillon v. Carl Bolander & Sons Co., 306 Minn. 155, 157-58, 235 N.W.2d 613, 614-15 (1975), for example, the court refused to allow a homeowner recovery of cost to replace destroyed trees described as "deformed, unhealthy, crooked and unsightly," despite their usefulness for soil retention and as a sound barrier, while in a companion case, Rector v. McCrossan, 306 Minn. 143, 149-50, 235 N.W.2d 609, 612-13 (1975), the court ruled that a church could receive the cost to replace attractive ornamental shade trees that served the same purposes.

85. One trend is discernable, however. It appears that courts may be more willing to award sums substantially in excess of likely diminution in value when the subject property is itself unique and expensive. *Compare, e.g.*, Melton v. United States, 488 F. Supp. 1066, 1075 (D.D.C. 1980) ($95,000 awarded to restore historic building); Maloof v. United States, 242 F. Supp. 175, 185 (D. Md. 1965) ($77,660 awarded to replace trees on showplace and historic estate); Neda Constr. Co. v. Jenkins, 137 Ga. App. 344, 349-50, 223 S.E.2d 732, 738 (1976) ($60,000 to repair substantial cracking and damage to elaborate support wall); City School Dist. v. McLane Constr. Co., 85 A.D.2d 749, 750-51, 445 N.Y.S.2d 258, 260-61 (1981) ($357,000 awarded for replacing ceiling beams in showcase swimming pool); Rhode Island Turnpike & Bridge Auth. v. Bethlehem Steel Corp., 119 R.I. 141, 162-65, 379 A.2d 344, 356-57 (1977) ($4.5 million awarded for repainting bridge) *with* Mercer v. J & M Transp. Co., 103 Ga. App. 141, 144, 118 S.E.2d 716, 718 (1961) ($17,000 cost to repair absurd when house before injury had no indoor plumbing and was in dilapidated condition).

judgment or that of the market, which often does not value the kind of personal concerns reflected in the owner's position. Here, as in other areas of the law, "reasonableness" is not an objective standard; it masks decisions based on the values and assumptions of the decisionmakers,[86] which may differ from the values that motivate those being judged.[87] Sometimes the difference in values between owner and decisionmaker has clear ideological overtones as in *Peevyhouse v. Garland Coal & Mining Co.*[88] or *Rock Island Improvement Co. v. Helmerich & Payne, Inc.*,[89] where the worth of land restoration was at issue. Even where the difference between owner and factfinder involves less political desires, as in the cases involving roofing tile or brick exteriors, there is a clash between those who place a premium on aesthetics (or at least the particular aesthetics at issue) and those more concerned with utility.

The problem is not simply that this rule ignores private contractual choices. Doctrines such as unconscionability, duress, mitigation of damages, and foreseeability have long limited freedom of contract for reasons of fairness and other public policy concerns. The problem is that courts do not adequately explain their decision to ignore those private contractual choices. If concerns of fairness and public policy are at issue, courts should say so explicitly, instead of speaking vaguely of "economic waste" based on the disproportion between the owner's valuation of contract performance and valuation by the factfinder and the market.

When courts do offer some explanation for rejecting the owner's interest in completion, they generally suggest that an award of cost to complete would overcompensate the owner and thereby provide a windfall. Certainly, a concern with overcompensation is warranted. If the owner does not, in fact, value completion at a level commensurate to the cost to complete, such an award *will* result in overcompensation. But

86. *See* Pilgrim Homes & Garages, Inc. v. Fiore, 75 A.D.2d 846, 849-50, 427 N.Y.S.2d 851, 854 (1980) (referee rejected some requests for cost to complete "based upon his own perception, sometimes without support in the record, of a less extensive mode of repair or that the defect was not of sufficient practical detriment to justify a costly repair").

87. *See, e.g.*, G. CALABRESI, IDEALS, BELIEFS, ATTITUDES, AND THE LAW 21-44 (1985); Donovan & Wildman, *Is the Reasonable Man Obsolete? A Critical Perspective on Self-Defense and Provocation*, 14 LOY. L.A.L. REV. 435, 462-67 (1981); Ehrenreich, *Pluralist Myths and Powerless Men: The Ideology of Reasonableness in Sexual Harassment Law*, 99 YALE L.J. 1177, 1178 (1990).

88. 382 P.2d 109 (Okla. 1962), *cert. denied*, 375 U.S. 906 (1963).

89. 698 F.2d 1075 (10th Cir.), *cert. denied*, 461 U.S. 944 (1983).

courts' concern about overcompensation may frequently be another way for courts to impose their values or market values on the owner; the judges assume overcompensation will result because they and the market assign a lower value to contract performance than does the owner.[90] Although the interest in avoiding overcompensation is justified, it should be vindicated in a manner more sensitive to the need to provide full compensation.[91]

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90. Courts also sometimes suggest that a windfall will result because the owner probably will not use the award to complete performance. *See, e.g., supra* note 56 and cases cited therein. Once again, the court may be projecting its own values, assuming the owner would not use the award to complete the contract because the judge would not do so. Moreover, even if the owner would not complete the construction, that does not by itself prove that the amount awarded would overcompensate. In microeconomic terms, an individual might choose to do something else with the money that will provide her the same amount of satisfaction as completing the original contract. *See generally* Birmingham, *Damage Measures and Economic Rationality: The Geometry of Contract Law*, 1969 DUKE L.J. 49, 53 (applying economic indifference curves to discussion of contract damages). It is only if the money represents the opportunity for the owner to do something she values more than completion that there is overcompensation. On the other hand, it is impossible to determine whether the owner's alternative use for the money offers equal or greater satisfaction, so the risk of overcompensation is high. This suggests that high costs to complete not be awarded if the owner does not intend to complete, but the owner should not then be limited to market value damages. *See infra* Part V.

91. Because there appear to be only a small number of cases in which courts actually have limited the owner to diminution in market value, one might question whether much concern over the effect of the reasonableness test is warranted. But the small number of cases may not accurately reflect the extent of the impact of the present rule. Most reported cases award cost to complete not because the court has approved the owner's value choices, but simply because the contract breach arises from work that was not performed at all or performed so defectively that any purchaser would consider the repairs necessary. In these cases, the diminution in market value almost invariably reflects directly the cost to complete the contract performance, so no question is raised regarding the worth of the performance. If one considers only those cases in which cost to perform diverges considerably from the market value loss, the number of times that courts reject cost to complete appears much more significant. Moreover, in a substantial number of cases the owner received the cost to complete only when the appellate court reversed an erroneous trial court award. *See, e.g.*, Alaska State Indus. Auth. v. Walsh & Co., 625 P.2d 831, 838-39 (Alaska 1980); Gilbert v. Tony Russell Constr., 115 Idaho 1035, 1037-40, 772 P.2d 242, 244-47 (Ct. App. 1989) (reversing trial court award of damages for the second time); Prier v. Refrigeration Eng'g Co., 74 Wash. 2d 25, 29, 442 P.2d 621, 624 (1968).

Moreover, the reported cases are only a rough guide to the impact of the rule on contract relations and litigation. Without an empirical study of experience in the trial courts, it is impossible to know with any accuracy how often the factfinders reject cost to complete because of differing views of the worth of completion, but it is probably safe to say that the effect is more widespread

III. ECONOMIC EFFICIENCY AND THE CHOICE OF DAMAGES

Among the factors to consider in evaluating any damages rule is the rule's impact on economic efficiency. Efficiency analysis requires consideration of the effect of the rule on the parties to the case in which it is applied and also on future contracting individuals. This Part explores the economic efficiency of both the standard courts currently use and an alternative rule mandating completion costs, concluding that considerations of economic efficiency do not dictate a "best" result. Thus, other concerns — especially the assurance of full compensation — should control.

A. EFFICIENCY OF OUTCOME UNDER THE ORIGINAL CONTRACT

Economic efficiency is attained if resources are used for their most highly valued purpose, as measured by consumer willingness to pay.[92] Encouraging parties to allocate resources efficiently is one possible aim for a contract remedy.[93] The question, then, is whether the choice of diminution in market value, cost to complete, or specific performance as a remedy for defective performance of a construction contract will produce the proper allocation.

Thirty years after Ronald Coase's path-breaking article on

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than the few reported appellate cases indicate. *See, e.g.*, Pilgrim Homes & Garages, Inc. v. Fiore, 75 A.D.2d 846, 849-50, 427 N.Y.S.2d 851, 854 (1980) (referee rejected some requests for cost to complete "based upon his own perception, sometimes without support in the record, of a less extensive mode of repair or that the defect was not of sufficient practical detriment to justify a costly repair;" "assuming the correctness" of referee's perception, referee should have awarded diminution in value). It also seems likely that the possibility of an award limited to diminution in value discourages some owners from choosing to pursue legal remedies at all.

92. R. POSNER, *supra* note 25, at 10; Kornhauser, *An Introduction to the Economic Analysis of Contract Remedies*, 57 U. COLO. L. REV. 683, 688-89 (1986).

93. *See, e.g.*, Birmingham, *Breach of Contract, Damage Measures, and Economic Efficiency*, 24 RUTGERS L. REV. 273, 284 (1970); Goetz & Scott, *Liquidated Damages, Penalties and the Just Compensation Model: Some Notes on an Enforcement Model and a Theory of Efficient Breach*, 77 COLUM. L. REV. 554, 556 (1977). The idea of crafting remedies or other contract rules to produce economic efficiency is not without its critics. *See, e.g.*, Farber, *Reassessing the Economic Efficiency of Compensatory Damages for Breach of Contract*, 66 VA. L. REV. 1443, 1456 (1980); Linzer, *supra* note 39, at 112-16; Macneil, *Efficient Breach of Contract: Circles in the Sky*, 68 VA. L. REV. 947, 951-53 (1982). The point made here, however, is that even if economic efficiency is a reasonable goal, no particular remedial solution is dictated.

social cost,[94] it should come as no surprise that, assuming no transaction costs, *every* possible choice of outcome in a particular case will produce economically efficient results. Whatever the remedy, the contract work will be completed only if it is the most highly valued use for the funds required. Even if courts were to order specific performance, the contract would be completed only if the owner considers performance to be worth at least the cost to complete. Otherwise, the owner would sell the right to performance to the contractor at an amount less than that cost. The only difference among the remedies is distributional; the choice of remedy determines whether the resources to pay for any work actually done come from the owner or the contractor, not whether the work is done.

The efficiency of outcome depends on the assumption that there are no transaction costs,[95] or that these costs are so low that they would not prevent the efficient allocation of the resources. After a court awards damages in an individual case, this assumption seems fully warranted. The owner need only determine how highly she values the proposed completion work, which may be a simple subjective determination without any transaction costs. If the owner wishes to consider the fair market value differential in making that assessment, transaction costs would include the price of an appraisal, but that cost will usually not be large enough to deter efficient allocation. Moreover, in most cases, an appraisal is likely to have been conducted as part of the litigation.

The situation is more complex if a court orders specific performance, and the efficient outcome involves the owner's sale of the right to compel performance. On the one hand, the transaction costs associated with the negotiation are likely to be small.[96] The parties to the negotiation are limited to the parties to the initial contract, who already have a history of dealings. The scope of the negotiation is narrow, limited to selection of the amount the owner will accept to forego performance by the contractor. On the other hand, the owner may threaten to require specific performance, thus making negotiations difficult and costly, and decreasing the likelihood of reaching an effi-

94. Coase, *The Problem of Social Cost*, 3 J. LAW & ECON. 1 (1960).

95. Transaction costs are administrative expenses arising from the organization of a market transaction. *Id.* at 15-16.

96. *See* Ulen, *The Efficiency of Specific Performance: Toward a Unified Theory of Contract Remedies*, 83 MICH. L. REV. 341, 370 (1984).

cient outcome.[97]

B. TRANSACTION COSTS IN FUTURE CONTRACTS

At least with respect to a choice between cost to complete and diminution of market value, then, the choice of remedy in any particular case seems irrelevant to the economic efficiency of the result; the work will be completed only if it is economically efficient to do so.[98] An equally important concern of economic efficiency, however, is the effect on future transactions.[99] The rule adopted in one case, if known to one or both parties to subsequent contracts, will affect how, and at what expense, they negotiate and implement future deals. The rule, and the contracting strategy thereafter adopted, will also affect the costs associated with future breaches, including the costs of litigating damage issues. These costs may be considered in three categories: the costs associated with formation of the contract, the costs incurred in informal dispute resolution after a breach, and the costs of litigation in formal resolution of the dispute.

Before analyzing these costs in detail, however, it is important to consider what level of knowledge the parties will have about the legal rule adopted. If neither party to subsequent transactions is aware of the damages rule, then they will create the contract without reference to it. The parties will negotiate and reach agreement motivated by business concerns and guided by the legal rules of which they *are* aware. Although questions of damages upon breach may enter their thoughts and their bargaining, the parties will fashion the contract based on their assumptions, possibly incorrect, about the legal rules of damage and based on their economic and other interests, and not in reaction to the particular rule of damages that courts select.[100]

If, on the other hand, one or both parties is aware of the

97. *See* Cooter, Marks & Mnookin, *Bargaining in the Shadow of the Law: A Testable Model of Strategic Behavior*, 11 J. LEGAL STUD. 225, 243 (1982); Yorio, *supra* note 39, at 1380-85.

98. Because the completion work will be done only if it is economically efficient, there can be no "economic waste" from an award of cost to complete. *See supra* note 94 and accompanying text.

99. *See* R. POSNER, *supra* note 25, at 18-19; Ulen, *supra* note 96, at 343.

100. Macaulay, *An Empirical View of Contract*, 1985 WIS. L. REV. 465, 466-68 [hereinafter Macaulay, *An Empirical View*]; Macaulay, *Elegant Models, Empirical Pictures, and the Complexities of Contract*, 11 LAW & SOC'Y REV. 507, 509-10 (1977); Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55, 60 (1963); *see* Feinman, *The Significance of Contract Theory*, 58 U. CIN. L. REV. 1283, 1305-06 (1990).

rule, the knowledge likely will affect their behavior in the contract formation process. Depending upon whether the rule favors or burdens the party with knowledge, that party may attempt to avoid explicit attention to the issue, thus adopting the favorable default legal rule, or to adopt explicit language changing the burdensome default rule.

The contract cases that raise the choice of damages problem considered here are, almost invariably, cases in which a contractor performs some kind of construction services. It seems fair to assume that, in the majority of the cases, the contractor — the performing party or promisor — will have equal or greater knowledge than the nonperforming party or promisee.[101] The contractor is in the business of performing construction services and generally has reason to know important legal rules controlling the operation of the business; certainly, the contractor has opportunity and incentive to discover those rules.[102] The other party to the contract may be a commercial or institutional owner who is knowledgeable about the law. Often, however, the other party to the contract is an individual homeowner or home buyer with little or no prior experience with these kinds of contractual arrangements, and therefore less likely to be familiar with the legal rules governing the relationship.

1. Current Rule

a. *Formation costs*

As described in Part I, courts generally favor cost to complete unless the completion cost is substantially higher than the

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101. *See* Ayres & Gertner, *supra* note 59, at 98 (it is sometimes reasonable to expect one party to a contract to be systematically informed about the default rule — for example, if one side is repeatedly in the relevant contractual setting and the other side rarely is).

It also seems likely that, when entering a construction contract, owners unfamiliar with the law will assume that they can enforce the precise terms of the agreement: That is, if the contract contains certain promises about the manner of performance — for example, specification of materials or size of the rooms — then they will receive precisely that performance, either directly from the contractor or from some other source, with the original contractor paying the cost of the additional work.

102. At least one recently published volume that describes basic principles of construction law for participants in construction projects contains a straightforward statement of the rules on damage awards. *See* B. JERVIS & P. LEVIN, CONSTRUCTION LAW: PRINCIPLES AND PRACTICE 8 (1988). Perhaps because of the confusing and inconsistent rulings of the courts, however, the book's statement is not completely accurate.

diminution in fair market value. In that situation, courts will measure damages by diminution in market value — often a nominal sum — unless they choose to override the disparity because of important personal values or interests of the owner, a decision rarely made.[103] Given this legal rule, a contractor could reasonably conclude that she will likely not have to pay the higher cost to complete damages.

Because the courts' current rule on damages leads most often to an award of the lesser diminution in fair market value, the contractor has little or no reason to raise the issue of damages when entering the contract. The owner, who probably assumes that she will truly get what she is promised and is unaware of the possible limitation on damage awards, will also not likely raise the issue. The virtual absence from the reported case law of contract clauses dealing with this damages issue[104] suggests that the current rule fails to encourage the parties to address the question in their contract negotiations.[105] The present rule thus promotes little attention to damages in the contract and therefore results in no formation costs during contract negotiations.

b. *Post-breach costs*

Once a breach has occurred, the parties will incur additional negotiation costs. To avoid litigation, the parties will have to agree on what the contractor will do or pay to compensate for the injury. Although some of the transaction costs of

103. *See supra* notes 44-50 and accompanying text.

104. The only exception is Leggette v. Pittman, 268 N.C. 292, 293, 150 S.E.2d 420, 421 (1966) (per curiam), where the court approved a jury instruction mandating award of cost to complete because the contract contained a clause guaranteeing replacement of defective work if reported within a year. In *Leggette*, however, there is no indication that the cost to repair — $1,300 — in fact exceeded diminution in market value. Whether courts would interpret a general guarantee clause of this kind as overriding the usual default rule on damages, thereby preventing a finding of economic waste, is not clear.

105. The absence of cases dealing with clauses making the contractor responsible for replacing defective work is curious, since the contract form suggested by the American Institute of Architects contains just such a clause. *See* AIA DOCUMENT A201, GENERAL CONDITIONS OF THE CONTRACT FOR CONSTRUCTION ¶ 13.2.2, *reprinted in* B. JERVIS & P. LEVIN, *supra* note 102, at 268. Perhaps more knowledgeable owners — who may frequently be advised by architects during the contracting process — do have such clauses routinely inserted in their contracts. If so, the absence of any discussion of these clauses in the case law suggests that the parties settled their disputes outside a courtroom. This, in turn, supports the proposition that encouraging parties to negotiate the remedy issue will reduce post-breach transaction costs. *See infra* text accompanying note 117.

this negotiation will be minimal,[106] the negotiation may still be costly, and perhaps unsuccessful, if the damages rule makes agreement more difficult. Under the prevailing rule, if the cost to complete exceeds the diminution in fair market value, the contractor may reasonably believe that a court will award the lesser amount of damages at trial. At the same time, the rule permits the factfinder to award the higher cost to complete if it is convinced that the owner has important reasons for desiring completion. Because the factfinder's subjective judgment controls the outcome, each party may be encouraged to believe that it can convince the factfinder to select its preferred method of damage valuation.[107] Because these divergent views about the proper theory of recovery necessarily produce diametrically different damage estimates, the parties will have difficulty in agreeing; thus, the negotiation will be more costly than if the rule mandated a theory of recovery, leaving only dollar estimates in dispute.

The parties will incur additional costs if they choose to litigate. Again, a flexible standard on damages increases costs. At trial, each party will likely present and/or challenge evidence on two different measures of damage,[108] requiring experts to

106. There will, for example, be no difficulty in identifying the parties who must be involved in the discussions.

107. In correspondence with the author of this Article, the lawyer for the defendant in Park v. Sohn, 89 Ill. 2d 453, 433 N.E.2d 651 (1982), noted that the parties in the case "litigated on the basis of deeply held convictions about who was 'right' until the expenses of litigation, inconvenience and time delay eventually far exceeded any monetary value to the case." Letter from H. Wayne Carmichael to Prof. Carol Chomsky (Oct. 23, 1989) (on file with author). In *Park*, liability arose from an implied warranty of habitability in the sale of a home, but the same issue discussed here — choice between cost to repair and diminution in value as the measure of damage — was a primary focus of the litigation and was the basis for the Illinois Supreme Court's reversal and remand. 89 Ill. 2d at 460-65, 433 N.E.2d at 656-57.

108. Most of the cases that have expressly considered the burdens of proof on damages have reached the sensible conclusion that the injured party may simply enter evidence of the cost to complete, while the contractor must introduce evidence of the disproportion between that figure and the loss in fair market value if claiming that award of cost to complete would be inappropriate. *See, e.g.*, Shell v. Schmidt, 164 Cal. App. 3d 350, 366, 330 P.2d 817, 827 (1958); P.G. Lake, Inc. v. Sheffield, 438 S.W.2d 952, 956 (Tex. Ct. App. 1969). A few courts have concluded that the owner must show both the cost of repair *and* that this cost does not exceed diminution in fair market value. Missouri Baptist Hosp. v. United States, 555 F.2d 290, 291-92 (Ct. Cl. 1977); Witty v. C. Casey Homes, Inc., 102 Ill. App. 2d 619, 623-24, 430 N.E.2d 191, 194-95 (1981). Once the issue of choice of damage theory is raised, however, both parties will usually want to present evidence on both measures of damages.

Interestingly, the nature of the conflict between the contractor and the

estimate cost to complete and to conduct appraisals and testify regarding fair market value differential. In addition, because the amounts at stake are often large and the choice of damages is based in part on the court's subjective valuation of the worth of full performance, the losing party will probably appeal, believing that an appellate court, composed of judges with potentially different values, may overrule the subjective choice of the trial court.[109] Thus, the parties will incur the additional expense of the appeal and often the costs of redetermining damages if the appellate court disagrees with the factfinder's opinion.[110]

Although the present rule thus produces low formation costs with respect to damages provisions in future contracts, the indeterminacy of the rule produces high post-breach transaction costs. A uniform default rule that guarantees award of a certain form of remedy may decrease transaction costs.

2. Guaranteeing Cost to Complete

a. *Formation costs*

Adopting a rule that guarantees cost to complete will affect all forms of contract transaction costs. First, it will certainly increase costs associated with entering a contract. The contrac-

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owner puts the contractor in a dilemma respecting trial strategy. A contractor seeking to limit recovery to diminution in value will wish to prove — consistent with the owner's claim — that a large sum is required to complete the work, making diminution in value more attractive. On the other hand, the contractor will also wish to show that the work can be done for less than the owner claims, in case the court ultimately chooses to award cost to complete anyway.

109. This is precisely what happened in Grossman Holdings, Ltd. v. Hourihan, 414 So. 2d 1037 (Fla. 1982), *remanding* 396 So. 2d 753 (Fla. Dist. Ct. App. 1981), and Eastlake Constr. Co. v. Hess, 33 Wash. App. 378, 655 P.2d 1160 (1982). *See supra* notes 81-85 and accompanying text.

110. The delay and expense of appeal may prevent either party from enjoying the fruits of victory. In *Eastlake*, after the plaintiff appealed to both the intermediate and highest courts of appeal on, *inter alia*, the issue of damages, the plaintiff failed to recover any damages because by then Eastlake "for all practical purposes was defunct." Letter from R.M. Holt, attorney for Eastlake, to Prof. Carol Chomsky (Oct. 27, 1989) (on file with author). In Alaska State Hous. Auth. v. Walsh & Co., 625 P.2d 831 (Alaska 1980), the defendant contractor was not paid the remainder of its fees until the litigation over the defective construction was terminated after remand from the Alaska Supreme Court. The contractor "came out much poorer" because of the length of time involved in the litigation, even though the trial court ultimately would have used the diminution in value as the measure of damages had the case not been settled shortly before retrial. Telephone interview with Allen McGrath, attorney for Alaska State Housing Authority (Oct. 1989).

tor entering an agreement is more likely aware of the damages rule than is the owner and, under the current rule, the contractor is unlikely to raise the issue of damages.[111] If the contractor knows that the default rule mandates liability for cost to complete with virtually no exception, however, she has more incentive to propose contract provisions that, in some or all instances, will limit recovery to the lesser of diminution in value or cost to complete.[112] Once the contractor explicitly raises the issue, the owner becomes aware, often for the first time, that the remedy for defective performance may not include completion of the work as promised. An owner who acquiesces to the limitation will at least be aware that the contractor is not making a promise to perform as specified, but rather a promise to perform or pay the fair market equivalent in loss of property value caused by the defective performance. The owner may even seek a reduction in price of the services, reflecting the new knowledge that the contract affords less protection than the owner may otherwise have expected.

On the other hand, the owner may insist on receiving full protection against breach for at least some of the contract specifications. As a result, formation costs will increase as the parties negotiate about which kind of damages to allow for breach of particular specifications and what price the owner will pay for the desired protection.[113] The issue may not be a simple one to resolve, because the parties will be discussing potential breaches of what may be relatively complex construction projects.

Moreover, the choice between cost to complete and diminution in value is important only when the two damage measures

111. *See supra* notes 101-02 and accompanying text.

112. *See* Ayres & Gertner, *supra* note 59, at 91-93. The authors suggest that it will sometimes be more efficient, in terms of both transaction costs and information sharing, to set a default rule according to what the parties (or the party most likely to know about the default rule) would *not* want. *Id.* at 91. This encourages the parties to share information and to reach agreement, which may be more efficient than having a court decide after the breach has already occurred. *Id.* at 93. Another school of thought suggests, however, that even when legal rules are known, "[o]ther factors, such as relations with one's suppliers and customers, the need for prompt performance, and advantages in market situations are usually more important" in contracting behavior. Feinman, *supra* note 100, at 1306. For example, a contractor may agree to accept responsibility for cost to complete in order to maintain a reputation for compliance with specifications, despite the potentially high cost of doing so.

113. Thus, there may be an increase in the price of the contract, as the contractor may wish to charge more for incurring the risk of paying higher damages.

diverge considerably, which usually will occur only when correction of the breach requires considerable redoing of work already defectively done.[114] Predicting which performances may later prove defective at a particular stage of the construction and how expensive those defects will be to repair may be difficult at this stage of the contract. By increasing the owner's concerns over adequate performance, the discussion may also complicate the relationship between the contractor and owner. On the other hand, in the context of settling on specifications for the entire project, the question of choice of damages may add only marginally to formation costs. The owner may be willing to accept a limitation of damages clause or a term requiring only "comparable workmanship" with regard to most of the contract specifications; the parties then need only identify the particular specifications that the owner wants executed precisely as promised. Furthermore, the parties will seek to limit the negotiations over damages to items of particular importance so that transaction costs of the negotiation will not exceed the expected return from changing the default remedy rule.

Once the owner knows that the contractor may not have to pay cost to complete, the owner might try other methods to protect against the contractor's default. She may, for instance, expend effort investigating potential contractors with former or current customers to ensure that the contractor ultimately selected is more likely than others to perform fully, or she may require the contractor to furnish a performance bond.[115] Both options entail further transaction costs, however, and neither offers certain protection; even well-recommended contractors make mistakes, and the surety's responsibility under the performance bonds may be identical to the contractor's liability.[116]

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114. Intuitively, at least, in cases of incomplete rather than defective performance the cost to complete is likely to be commensurate with the difference in value between the completed and unfinished jobs, whether measured subjectively from the point of view of the contracting party or objectively by fair market value. Indeed, none of the reported cases addressing the choice between cost to complete and diminution in value arose solely from instances of incomplete construction.

115. *See* Muris, *supra* note 61, at 387.

116. *See* J.D. LAMBERT & L. WHITE, HANDBOOK OF MODERN CONSTRUCTION LAW 143 (1982). A performance bond typically provides that, whenever the contractor is in default, the surety may "promptly remedy the default" or "shall . . . [c]omplete the [c]ontract in accordance with its terms" or arrange for another contractor to complete the work. *Id.* at 134. If the contractor can pay diminution in value to cure the default, presumably the surety can do the same.

b. *Post-breach costs*

Although formation costs likely will increase with a damage rule that does not favor the contractor, post-breach transaction costs should decrease. If the parties do not change the default rule, cost to complete will be guaranteed and only the amount of cost to complete will be at issue, thus simplifying settlement negotiation and litigation. In addition, facing a guaranteed award of cost to complete, the contractor may take extra precautions to perform properly. On the other hand, the contractor may more readily litigate liability issues to avoid paying for completion, thus shifting, but not reducing, the litigation costs under the current rule. In addition, any extra precautions the contractor undertakes will entail some additional cost, although simply being careful to comply with the contract specifications should not add considerably to performance cost. Moreover, if the parties limit the application of cost to complete damages to features of particular significance to the owner, the contractor's additional cost should be minimal.

Similarly, if the contract alters the default rule and limits damages to diminution in market value, post-breach costs are reduced. The parties need only determine how much the breach affects the market value. If, instead, the parties specify a particular amount as liquidated damages for specific failures, the post-breach transaction costs further decrease.[117]

Overall, then, it may be economically efficient for courts to adopt a rule guaranteeing award of cost to complete damages. Such a rule would encourage the parties to identify specifications of particular significance to the owner and to allocate for themselves the risks and costs of breach, saving substantial set-

117. This analysis assumes that the liquidated damages provision will be enforceable. Under current case law, which frequently refuses to enforce liquidated damages provisions construed to be penalties, the existence of a liquidated damages provision does not end the dispute over damages. *See, e.g.*, Camelot Music, Inc. v. Marx Realty & Improvement Co., 514 So. 2d 987, 990 (Ala. 1987); Helstrom v. North Slope Borough, 797 P.2d 1192, 1199 (Alaska 1990); Burns v. Hanover, Inc., 454 A.2d 325, 327 (D.C. 1982); Stride v. 120 West Madison Bldg. Corp., 132 Ill. App. 3d 601, 605, 477 N.E.2d 1318, 1321 (1985); Tate v. Action Moving & Storage, Inc., 95 N.C. App. 541, 549, 383 S.E.2d 229, 233 (1989); Ditommaso Realty, Inc. v. Moak Motorcycles, Inc., 309 Or. 190, 198, 785 P.2d 343, 347 (1990); Safari, Inc. v. Verdoon, 446 N.W.2d 44, 46 (S.D. 1989); Phillips v. Phillips, 792 S.W.2d 269, 271 (Tex. 1990); Lind Bldg. Corp. v. Pacific Bellevue Dev., 55 Wash. App. 70, 77, 776 P.2d 977, 981-82 (1989). As other commentators have pointed out, however, it may be more efficient to permit the parties to specify liquidated damages even where the amounts do not accurately reflect actual compensatory damages. *See* Goetz & Scott, *supra* note 93, at 578-86.

tlement and litigation costs. Whether increased contract negotiation costs will offset these savings is, however, unclear.[118] Moreover, a rule invariably mandating award of cost to complete would result in substantial overcompensation of the owner in cases in which the owner's subjective valuation of the injury is, in fact, much lower than the high cost of completion. This result unfairly burdens contractors and thus courts will likely find it to be unacceptable. Perhaps the best approach is to adopt a rule that makes award of completion cost more certain than it is presently, so that parties will negotiate measurement of damages, but that permits courts to offer relief from payment of completion costs when overcompensation is particularly likely. Such a rule — proposed in Part V — would result in the reduction of post-breach transaction costs, offset in part by a modest increase in contract negotiation costs.

IV. A DOCTRINAL COMPARISON

The problem of choosing between cost to complete and diminution in value arises not only in contract cases, but also in tort cases involving trespass, negligence, or nuisance claims. Typical scenarios include landowner claims for injury to property from blasting operations, fires, toxic spills, unapproved removal of trees, and negligence in neighboring construction projects. Tort claims may also arise in the context of a contractual relationship, where the owner alleges both breach of con-

118. Like a standard mandating cost to complete, a rule guaranteeing award of specific performance will encourage the parties to negotiate damage limitations in the contract, thereby raising formation costs, and will add certainty to the outcome of litigation, thereby decreasing settlement and litigation costs. The effects of requiring specific performance differ in two important ways, however.

First, if the parties do not agree to change the rule and a court orders specific performance, the parties have an opportunity to negotiate a settlement by which the injured party agrees to accept a sum of money in lieu of the contractor's full performance. As several commentators have suggested, strategic considerations, differences in negotiating skill, and the owner's ability to use the ultimate threat of specific performance may impede the negotiations, resulting in both substantial costs and inefficient outcomes. *See* Cooter, *The Cost of Coase*, 11 J. LEGAL STUD. 1, 17-19 (1982); Cooter, Marks & Mnookin, *Bargaining in the Shadow of the Law: A Testable Model of Strategic Behavior*, 11 J. LEGAL STUD. 225, 243 (1982); Yorio, *supra* note 39, at 1380-85, 1402-03.

Second, if the court awards specific performance, there will be costs associated with fashioning and enforcing the court's decree, which may more than offset the savings from avoiding the necessity of computing damage amounts. In addition, the contractor faced with the specter of specific performance may choose more often to contest and litigate liability.

tract and negligence.[119] In both contract and tort cases, the court must value the difference to the plaintiff of having the affected property in one condition versus having it in another condition. In contract cases, the difference is between the property as it is and as it was promised; in negligence, trespass, or nuisance cases, it is the property as it is and as it began.

Despite this similarity, courts have most often analyzed the damages question in tort and contract cases independently, with little or no reference to the parallel doctrine. This Part explores the standard developed in tort to determine in what respects it differs from the contract rule and whether the difference between contract and tort justifies the dissimilar treatment.[120] In the next section, the Article considers whether the tort standard offers a reasonable model for construction contract cases.

The *Restatement (Second) of Torts* specifies that whenever there is injury to land, damages should include "the difference between the value of the land before the harm and the value after the harm, or at [the injured party's] election in an appro-

119. *See, e.g.,* Rosos Litho Supply Corp. v. Hansen, 123 Ill. App. 3d 290, 291, 462 N.E.2d 566, 568 (1984) (plaintiff sued architect and concrete contractors for both negligence and breach of contract, winning favorable jury verdict on tort but not contract claim); Stony Ridge Hill Condominium Owners Ass'n v. Auerbach, 64 Ohio App. 2d 40, 42, 410 N.E.2d 782, 784 (1979) (plaintiffs sued roof contractor for negligent construction, breach of warranty, willful breach of contract, and fraudulent misrepresentation).

120. The question whether an owner should receive cost to repair or diminution in market value is also raised in property cases that allege waste or the violation of lease clauses promising to repair or restore. In waste cases, courts almost invariably award diminution in market value, apparently because courts presume that the owner, who holds only a reversionary interest, is therefore concerned only with market value. *See, e.g.,* Ratner v. Willametz, 9 Conn. App. 565, 584, 520 A.2d 621, 632 (1987); Lustig v. U.M.C. Indus., 637 S.W.2d 55, 58 (Mo. Ct. App. 1982). In lease cases, in contrast, courts award cost to repair, but only if it does not exceed diminution in market value. *Compare, e.g.,* Polster, Inc. v. Swing, 164 Cal. App. 3d 427, 431-33, 210 Cal. Rptr. 567, 570-71 (1985) *and* Siegler v. Robinson, 600 S.W.2d 382, 385-86 (Tex. Ct. App. 1980) *with* Dodge St. Bldg. Corp. v. United States, 341 F.2d 641, 645 (Ct. Cl. 1965) (building would be worth $60,000 less if restored to original condition at cost of $47,243; landlord recovers nothing) *and* Fuselier v. United States, 111 F. Supp. 471, 473 (W.D. La. 1953) (landlord cannot recover $3,890 as cost to remove concrete emplacements and earthen works because value of land diminished only by $300).

The property cases all use a more rigid rule than do the contract or tort cases, never considering any special value that completion might have for the owner. That rule may be appropriate in the waste and lease cases, where owners typically hold the property for investment, but not in the contract or tort cases.

priate case, the cost of restoration that has been or may be reasonably incurred."[121] Value, in turn, is defined as the greater of the exchange value or the value to the owner.[122]

The *Restatement (Second)* provision itself gives no guidance on what would be "an appropriate case" for using cost of restoration, or when such costs are "reasonably" incurred, but the official comment is more helpful. The comment suggests that costs of restoration are ordinarily allowable as the measure of damages; courts will use diminution in value, however, if the cost of restoring the land to its original condition is "disproportionate" to the diminution in value — "unless there is a reason personal to the owner for restoring the original condition."[123] In the latter case, the damages will ordinarily include the amount necessary for repairs, even though this amount might be greater than the total value of the property.[124] The *Restatement (Second)* is silent on whether there is any upper limit to the amount of damages awarded when such a "reason personal to the owner" exists.

A review of cases determining damages for trespass, negligence, and nuisance provides further definition to the Restatement's standard, but it also reveals some significant variations on that formula.[125] The greatest difference is in those jurisdictions that place a more restrictive limit on when an owner can receive cost to repair or restore. Although articulated in varying ways, these courts essentially limit the owner's damages to

121. RESTATEMENT (SECOND) OF TORTS § 929(a) (1977). For conversion or total destruction, the Restatement awards the "value" of the thing destroyed, meaning "exchange value or the value to the owner if this is greater than the exchange value." *Id.* §§ 911, 927. Because land is usually injured but not totally destroyed, it is the provision discussed in text that usually applies.

122. *Id.* § 911.

123. *Id.* § 929 comment b.

124. *Id.* There seems to be no difference between the standards articulated in the *Restatement (First) of Torts* and the *Restatement (Second) of Torts*. In the operative provision itself, the only difference was the omission of the phrase "in an appropriate case" to describe when an injured party could select cost of restoration. RESTATEMENT (FIRST) OF TORTS § 929(a) (1939). The comments were identical in the two versions, however, and the reporter of the *Restatement (Second)* noted that the wording of the section had been changed "in the interest of clarity." RESTATEMENT (SECOND) OF TORTS § 929 app. reporter's note (1977).

125. Several courts have expressly noted the variations among the jurisdictions, and sometimes within a single jurisdiction, in the course of attempting to rationalize the damage calculations in their own states. *See, e.g.*, Heninger v. Dunn, 101 Cal. App. 3d 858, 862-864, 162 Cal. Rptr. 104, 106-108 (1980); "L" Invs., Ltd. v. Lynch, 212 Neb. 319, 322, 322 N.W.2d 651, 654 (1982).

the lesser of cost to repair and diminution in market value.[126] Several courts use diminution in value as the standard measure, but consider cost to repair as a good or even the best evidence of the amount of the diminution.[127]

126. Several courts state that diminution in value is the standard measure, but cost to repair should be used if that amount is less. *See, e.g.*, Blanton & Co. v. Transamerica Title Ins. Co., 24 Ariz. App. 185, 188, 536 P.2d 1077, 1080 (1975) (land injured when defendant removed fill; plaintiff showed no restoration possible because of instability of soil, so award of $7,500/acre diminution proper); Charles v. Reuck, 179 Cal. App. 2d 145, 146-48, 3 Cal. Rptr. 490, 491-92 (1960) (logging truck damaged barn; evidence showed total value of barn was $5,000, cost to repair between $4,000 and $7,984, cost to replace $20,844; trial court award of $5,000 within proper range); Kirst v. Clarkson Constr. Co., 395 S.W.2d 487, 493-94 (Mo. Ct. App. 1965) (home damaged from nearby blasting; diminution in value of $3,500, repair costs of $315 to $4,030; jury award of $1,150 proper because within range of cost to repair evidence and less than diminution in value).

Other courts articulate the rule in the reverse, stating that cost to repair is the standard measure, but not if it exceeds diminution in value. *See, e.g.*, Newsome v. Billips, 671 S.W.2d 252, 253-55 (Ky. Ct. App. 1984) (mine blasting caused structural damage to plaintiff's house; cost to repair shown at between $9,500 and $12,500, diminution in value at $600 or $800; jury properly instructed to limit damages to $800); Stony Ridge Hill Condominium Owners Ass'n v. Auerbach, 64 Ohio App. 2d 40, 41, 48, 410 N.E.2d 782, 784, 788 (1979) (damages of $14,543 for cost to repair negligently constructed roof proper; diminution in value is limit, but no evidence of diminution presented).

Still others state directly that the lesser amount prevails. *See, e.g.*, Mozzetti v. City of Brisbane, 67 Cal. App. 3d 565, 576, 136 Cal. Rptr. 751, 757 (1977). At least one court stated that the measure of damages is diminution in value, without reference to cost to repair. S.S. Steele & Co. v. Pugh, 473 So. 2d 978, 982 (Ala. 1985). Because the plaintiff apparently sought damages only for diminution in value, however, and neither party introduced evidence of cost to repair, it is not clear whether the court would have used cost to repair as a measure in a case in which those costs were less than the diminution.

Whether a court determines that cost to repair or diminution in value is the "standard" measure often depends upon whether the court views the damage to the property as temporary or permanent. If damage is considered only temporary, then cost to repair is the standard; if damage is permanent, then diminution in value is the norm. *See* cases cited *supra*; *see also* D. DOBBS, HANDBOOK ON THE LAW OF REMEDIES 313-14 (1973). "Permanent" does not necessarily mean "incapable of repair," however. An injury may simply be deemed permanent if cost to repair exceeds diminution in value. *See, e.g.*, United States Steel Corp. v. Benefield, 352 So. 2d 892, 894 (Fla. Dist. Ct. App. 1977). In any event, under all of these articulations, it is the lesser of the two values that prevails.

127. *See, e.g.*, Stratford Theater, Inc. v. Town of Stratford, 140 Conn. 422, 424, 101 A.2d 279, 280 (1953) (diminution may be measured by cost to repair if that cost is less than fair market value of property before injury); Delay Mfg. Co. v. Carey, 91 N.H. 44, 45-46, 13 A.2d 152, 153 (1940) (diminution in value from removal of electrical wiring fairly measured by cost of $274 to restore, though owner ends up with new wiring instead of old); Clay v. Jersey City, 74 N.J. Super. 490, 496-97, 181 A.2d 545, 549 (1962) (evidence of $99,997 cost to repair structural damage from sewer leakage to be considered in determining

Other courts, although applying cost to restore as the appropriate measure of damages in all cases of reparable injury to property, use the fair market value of the property before the injury, rather than the diminution in value, as the ceiling on the damage award.[128] In their view, limiting damages to diminution in value would not fairly compensate the owner, at least where the owner planned to use the damage award to perform the repairs.

Most frequently, however, courts articulate a standard approximating the *Restatement (Second)* version. The aim is to compensate the injured party fully for the injury. Courts assume that most owners desire to repair the damage done to their property,[129] so to compensate fully the court must award sufficient damages to pay the cost of repair. Courts that have permitted high damage awards, often in excess of diminution in market value, frequently point to reasons "personal to the owner" as justification, as did the *Restatement (Second)*.[130]

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diminution in value; court awarded at least $89,649 for diminution), *aff'd*, 84 N.J. Super. 9, 200 A.2d 787 (1964).

128. *See, e.g.*, Southern Indiana Gas & Elec. Co. v. Indiana Ins. Co., 178 Ind. App. 505, 517, 383 N.E.2d 387, 395 (1978) (homeowner received $10,700 to repair home largely destroyed by explosion of gas line); *"L" Invs.*, 212 Neb. at 321, 322 N.W.2d at 653 (plaintiff received $2,640 for damage to wall and windows when motor vehicle struck building); *see also Stratford Theater*, 140 Conn. at 424, 101 A.2d at 280 (proper measure of damages is diminution in value, which may be measured by cost to repair if such cost is less than fair market value before the injury).

129. Virtually all of the tort cases involve some kind of physical injury to the owner's property, causing damage of a kind that requires "repair." Contract cases, in contrast, often involve injury resulting from work that is done differently from the specifications but that does not necessarily leave the property in a damaged condition. Thus, courts assume that tort case plaintiffs are more likely to desire to restore their property to its original condition than are contract case plaintiffs to wish to complete the promised performance.

130. *See, e.g.*, Maloof v. United States, 242 F. Supp. 175, 183-85 (D. Md. 1965) (plaintiff awarded $77,660 to replace plants and trees destroyed by fire on showplace estate); G & A Contractors, Inc. v. Alaska Greenhouses, Inc., 517 P.2d 1379, 1387 (Alaska 1974) (plaintiff received $12,550 for restoring vegetation and trees on land used for nursery business, though defendant claimed award was grossly disproportionate to loss in value); Myers v. Arnold, 83 Ill. App. 3d 1, 3, 6, 403 N.E.2d 316, 318, 321 (1980) (plaintiff received $12,000, well in excess of diminution in value, for removing excess concrete dumped on land at site where plaintiff intended to build home); Samson Constr. Co. v. Brusowankin, 218 Md. 458, 471, 147 A.2d 430, 438 (1958) (plaintiffs awarded $6,500, within range of evidence of cost to restore trees to unimproved lots); Rector of St. Christopher's Episcopal Church v. McCrossan, 306 Minn. 143, 144, 150, 235 N.W.2d 609, 610, 613 (1975) (en banc) (road contractor destroyed ornamental shade trees on plaintiff church's property; jury should consider both cost to replace and diminution in value and can award damages greater than

Most often, the "personal reasons" involve the desire of an owner to live in and enjoy her own home and the land surrounding it,[131] but several cases accepted "special reasons" related to the non-homestead use of the property.[132] Once the court has identified a "personal reason," the court rarely denies recovery of cost to restore.[133]

Courts that accept the availability of cost to restore based on reasons personal to the owner expressly reject diminution in value and fair market value as an explicit and unvarying ceiling to recovery. At the same time, however, courts often state that some limits exist to the amount that can be recovered. They

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diminution); Morris v. Ciborowski, 113 N.H. 563, 565, 311 A.2d 296, 297 (1973) (per curiam) (plaintiff received $16,000 for replacing trees on residential property); Berg v. Reaction Motors Div., 37 N.J. 396, 405, 181 A.2d 487, 495 (1962) (plaintiffs awarded $25,605 to repair damage to homes caused by tests of supersonic rocket engine, though diminution in value might be only $3,700); Adcock v. Rollins Protective Serv. Co., 1 Ohio App. 3d 160, 160-61, 440 N.E.2d 548, 549 (1981) (security system testing damaged white floor tiles in home; plaintiff may receive cost to repair even if it exceeds diminution in value); Anderson v. Bauer, 681 P.2d 1316, 1324 (Wyo. 1984) (plaintiffs received awards ranging from $21,428 to $39,433 for repair of homes damaged by water seepage).

131. *See, e.g., Samson Constr.*, 218 Md. at 462, 147 A.2d at 432-33 (land on which owners intended to build homes stripped of trees); *Morris*, 113 N.H. at 564, 311 A.2d at 298 (trees on residential property destroyed); *Berg*, 37 N.J. at 399, 406, 181 A.2d at 489, 492 (tests of supersonic rocket engine caused structural damage to homes); *Adcock*, 1 Ohio App. 3d at 160, 440 N.E.2d at 549 (security system testing damaged white floor tiles in home); *Anderson*, 681 P.2d at 1324 (water seepage damaged homes).

132. *See, e.g., Maloof*, 242 F. Supp. at 183 (owner purchased manor house and grounds to house and exhibit art collection and to use as shrine to first President of United States under Articles of Confederation; fire destroyed trees on estate); *G & A Contractors*, 517 P.2d at 1387 (owner used land for nursery business and planned to create showplace surrounding creek that defendant diverted); *Rector of St. Christopher's*, 306 Minn. at 144, 235 N.W.2d at 610 (road contractor destroyed ornamental shade trees on church property); *cf.* Puerto Rico v. S.S. Zoe Colocotroni, 628 F.2d 652, 673, 674 n.21 (1st Cir. 1980) (pursuant to statute, Puerto Rico can claim cost to restore estuarial ecosystem damaged by oil spill; common law standard might permit same result based on special value of property to injured party), *cert. denied*, 450 U.S. 912 (1981).

133. *See supra* note 130 and cases cited therein. *But see* Clark v. J.W. Conner & Sons, Inc., 441 So. 2d 674, 675-76 (Fla. Dist. Ct. App. 1983) (owner cannot get cost to restore after defendant erroneously built road across unimproved land, cutting down trees and leaving debris; insufficient that owner intended to build residential homes and had already hired architect and surveyor for project); Baillon v. Carl Bolander & Sons Co., 306 Minn. 155, 156-57, 235 N.W.2d 613, 614-15 (1975) (en banc) (homeowner cannot get cost to replace "deformed, unhealthy, crooked, and unsightly trees" with new ones, despite admitted usefulness for soil retention and sound barrier).

Moreover, not all courts accept the notion that "personal reasons" can justify an award in excess of diminution in value. *See supra* note 126 and cases cited therein.

articulate the limit in various ways: Some cases suggest that cost to repair is appropriate where repair is "practical" and "reasonable;"[134] others refer to expenditures allowable unless "wholly disproportionate to the value of the land"[135] or "disproportionate to the actual injury;"[136] one court said the award should not "encourage economically wasteful remedial expenditures."[137] Because few cases actually impose a limit on the amount recovered, it is difficult to determine just what these statements mean.[138] The cases indicate, however, that courts will often award extensive damages in order to permit the owner to restore the property. For example, courts have upheld awards of $16,000 to replace trees defendant removed from the owner's property;[139] $25,605 for structural damage from testing jet engines where the diminution in value was $3700;[140] $12,550 for restoring vegetation and trees to a few acres of a tract purchased for only $4000 per acre;[141] $9,674 for replanting shrubs and hedges a contractor removed to widen a road;[142] $90,000 to complete a $40,000 restoration job;[143] and $3.6 million to repair an historic church that suffered structural damage

134. *See, e.g.*, Heninger v. Dunn, 101 Cal. App. 3d 858, 864, 162 Cal. Rptr. 104, 108 (1980); *Rector of St. Christopher's*, 306 Minn. at 145-46, 235 N.W.2d at 611; *Adcock*, 1 Ohio App. 3d at 160-61, 440 N.E.2d at 549.

135. Myers v. Arnold, 83 Ill. App. 3d 1, 6, 403 N.E.2d 316, 321 (1980).

136. Moulton v. Groveton Papers Co., 114 N.H. 505, 510, 323 A.2d 906, 911 (1974).

137. Board of County Comm'rs v. Slovek, 723 P.2d 1309, 1316 (Colo. 1986) (en banc).

138. Many of the cases simply affirm an award of cost to repair, thus confirming that the award is within the limits of practicality and reasonableness but offering no information on when those limits might be reached. Many others state the standard in the context of reversing trial court rulings that erroneously limited damages to diminution in value or denied all damages because the plaintiff had offered evidence only of cost to repair and not diminution. Indeed, it often appears from the cases that, despite relative agreement among the appellate courts that cost to repair is a reasonable remedy in most cases, many of the trial courts continue in some confusion over the proper standard to be applied and are frequently reversed for unreasonably limiting the damage awards.

139. Morris v. Ciborowski, 113 N.H. 563, 564-65, 311 A.2d 296, 298-99 (1973) (per curiam).

140. Berg v. Reaction Motors Div., 37 N.J. 396, 399-401, 181 A.2d 487, 491-92 (1962).

141. G & A Contractors, Inc. v. Alaska Greenhouses, Inc., 517 P.2d 1379, 1387 (Alaska 1974).

142. Gross v. Jackson Township, 328 Pa. Super. 226, 227-28, 476 A.2d 974, 975-76 (1984).

143. Melton v. United States, 488 F. Supp. 1066, 1069, 1075 (D.D.C. 1980). In *Melton*, the plaintiff successfully sued the United States for negligence in selecting and supervising the contractor performing the restoration work on

from faulty excavation on neighboring property[144] — even though the plaintiff church had no present intention to perform the repairs.[145] Indeed, in only a handful of cases did the court refuse to grant the full cost to restore, and those were instances of what might be considered truly exorbitant expense.[146]

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her property. *Id.* If the contractor had been solvent, the case could easily have arisen as a breach of contract suit instead.

144. Trinity Church v. John Hancock Mut. Life Ins. Co., 399 Mass. 43, 44 n.3, 46-47, 502 N.E.2d 532, 533 n.3, 536 (1987).

145. *Id.* at 49-50, 502 N.E.2d at 540-41 (dissenting opinion). The court agreed with the plaintiff that the cost to repair was a reasonable yardstick to measure the injury so that if, in the future, it became necessary to perform the repairs, the Church would have recovered sufficient funds from the defendants to pay for their ratable portion of the damage. *Id.* at 47-48, 502 N.E.2d at 536-37. *Contra* Puerto Rico v. S.S. Zoe Colocotroni, 628 F.2d 652, 676-77 (1st Cir. 1980) (reversing award of $5.5 million for replacement of marine organisms that oil spill destroyed because plaintiff did not presently plan to reintroduce organisms, which would die again in present polluted state of estuarial ecosystem), *cert. denied*, 450 U.S. 912 (1981).

146. In Heninger v. Dunn, 101 Cal. App. 3d 858, 861, 866, 864, 162 Cal. Rptr. 104, 106, 109 (1980), for example, the court found that $241,257 to restore trees and undergrowth was a "manifestly unreasonable expense" in relation to the value of the land, which had actually increased from $179,000 to $184,000 when the defendant bulldozed an unauthorized access road on the land. The trial court, however, had denied all recovery of restoration costs because there was no depreciation in the value of the land. As a result, the appellate court simply remanded for the trial court to exercise its discretion in awarding cost to restore, with the understanding that full restoration would be considered unreasonable.

In Maloof v. United States, 242 F. Supp. 175, 184-85 (D. Md. 1965), another case involving restoration of trees and vegetation, the court found that replacing each and every lost plant would be excessive. The court did, however, award $77,660 to replace a substantial amount of the lost vegetation, in order to approximate but not duplicate the aesthetics of the house and its gardens. In *S.S. Zoe Colocotroni*, the court rejected a claim for $7.1 million to remove polluted and damaged mangrove trees and sediment from an area an oil spill affected because the restoration plan was "impractical, inordinately expensive, and unjustifiably dangerous" to the remaining healthy plants and animals. 628 F.2d at 676. In these two cases, the courts seemed to be rejecting the claims for full restoration not simply, and perhaps only marginally, because of the great cost; the courts focused more on whether the restoration plan was sensibly designed and necessary to reproduce the pre-injury status of the property.

Finally, in Ewell v. Petro Processors of Louisiana, Inc., 364 So. 2d 604, 608-09 (La. Ct. App. 1978), *cert. denied*, 366 So. 2d 575 (1979), the plaintiffs were owners of a one-eighth interest in an 1,100-acre tract of land, about half of which was swampland. The defendant, an industrial waste disposal company, had negligently permitted toxic waste materials, consisting largely of nonbiodegradable chlorinated hydrocarbons, to leak onto the plaintiffs' land. *Id.* at 605-06. According to an expert witness at trial, the 550 acres damaged were worth approximately $200,000. *Id.* at 609. Plaintiffs, however, sought to recover the cost of restoring the land, which would involve continuous operation

Courts in Georgia have articulated the standard in a way that reflects the general willingness to award large amounts for cost to repair in tort cases. In Georgia, an owner is entitled to receive the cost to repair or restore the property unless restoration would be "an absurd undertaking."[147] Under this standard, courts have permitted awards of $7,700 to replace wrongly-colored brick[148] and of $60,000 to repair structural damage to a home worth $35,000.[149] Other Georgia courts, however, have found a $16,000 restoration cost absurd when the house before injury was dilapidated and worth only about half the cost of repairs,[150] and affirmed a jury award of $50,000 for a warehouse destroyed by fire when evidence showed the cost to restore would have been $576,000.[151]

These tort cases suggest ways in which the rules for choosing between cost to complete and diminution in value in tort cases differ from the standard adopted in contract cases.[152] First, the tort cases focus their inquiry more directly on what the *Restatement (Second)* calls the "value to the owner," which in many instances is greater than the fair market value. The factfinder, whether judge or jury, focuses generally on the need to compensate the owner fully, considering for that purpose

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of 100 trucks for seven years and cost $170 million. *Id.* The owners of the remaining seven-eighths interest in the land, other members of the Ewell extended family, had settled with the defendants. *Id.* at 606. The trial court ruled, and the appellate court confirmed, that the plaintiffs could recover only loss in value, not cost of restoration, under these circumstances; the jury then awarded $25,000, representing the plaintiffs' one-eighth interest in the land. *Id.* at 608-09.

147. *See* Georgia-Carolina Brick & Tile Co. v. Brown, 153 Ga. App. 747, 752, 266 S.E.2d 531, 539 (1980); Atlanta Recycled Fiber Co. v. Tri-Cities Steel Co., 152 Ga. App. 259, 264, 262 S.E.2d 554, 558 (1979); Neda Constr. Co., Inc. v. Jenkins, 137 Ga. App. 344, 350, 223 S.E.2d 732, 738 (1976); Mercer v. J & M Transp. Co., 103 Ga. App. 141, 142-43, 118 S.E.2d 716, 718 (1961).

148. *Georgia-Carolina Brick & Tile*, 153 Ga. App. at 750, 754-55, 266 S.E.2d at 534, 539.

149. *Neda Constr. Co.*, 137 Ga. App. at 350, 223 S.E.2d at 738.

150. *Mercer*, 103 Ga. App. at 143, 118 S.E.2d at 718.

151. *Atlanta Recycled Fiber Co.*, 152 Ga. App. at 261-62, 262 S.E.2d at 556.

152. In the textual discussion, I compare the contracts standard with the one that courts have adopted most widely in tort cases, as reflected in the *Restatement (Second) of Torts*. Some courts' use of a rule that awards the lesser of diminution in value and cost to complete, *see supra* note 126 and accompanying text, seems wrong because it does not permit recovery for injury the owner valued at an amount higher than the market. Limiting an award of cost to repair to the pre-injury market value of the property is less restrictive, *see supra* note 128 and accompanying text, but still places an artificial ceiling on recovery of actual injury to the owner. Thus, I do not discuss these alternatives in the present comparison.

any evidence presented to establish value. This evidence not only includes testimony about cost to repair and/or diminution in market value, but also includes such things as the market value of the property as a whole, the nature of the owner's use of the property, the reasons for wanting the land restored to its former condition, and the aesthetic or other intangible value placed on the property or its repair by the owner. The factfinder then considers all the evidence and selects an appropriate damage figure, which courts uphold if it is less than the maximum figure the evidence establishes.[153] One court noted that the choice of the proper amount of damages must be left "to the sound discretion of a jury, in the exercise of a reasonable sympathy with the feelings of the owner."[154]

In the contract cases, by contrast, the inquiry tends to focus exclusively on cost to complete and diminution in market value, with no indication that any other intermediate value representing special value to the owner might exist. Although a court, in instructing the jury or in considering the validity of a damage award, may speak generally of the need to compensate and give to the owner "the benefit of the bargain," the factfinder has no opportunity to select any reasonable figure within the range of the evidence.

Second, perhaps as a consequence of the increased focus on value to the owner, courts hearing tort claims seem more hesitant to cap the amount that can be recovered for loss in value. The articulated standards are similar: Courts speak of economic waste and gross disproportion in the contract cases and of practicability, reasonableness, and disproportion in the tort cases. But in the tort cases, courts seem more sympathetic to the aesthetic and other reasons that owners give for desiring cost to repair and therefore are less likely to find those costs unacceptably high.

Third, if courts reject cost to repair as excessive, the tort

153. *See, e.g.*, Charles v. Reuck, 179 Cal. App. 2d 145, 147-48, 3 Cal. Rptr. 490, 491-92 (1960) (trial judge awarded $5,000; evidence showed value of damaged barn was $5,000, repairs would cost $4,000 to $7,984); Samson Constr. Co. v. Brusowankin, 218 Md. 458, 465-66, 147 A.2d 430, 437-438 (1958) (jury awarded $4,000 and $2,500 to two plaintiffs for damage from removing trees from property; plaintiff's evidence showed restoration costs of $1,482 for planting grass to $7,200 for planting smaller trees); Brereton v. Dixon, 20 Utah 64, 65-68, 433 P.2d 3, 5, 7 (1967) (jury awarded $5,700 for fire damage to peach and pear trees, well within evidence that maximum amount of injury was $24,000).

154. Neda Constr. Co. v. Jenkins, 137 Ga. App. 344, 350, 223 S.E.2d 732, 738 (1976) (quoting Cherry v. McCutchen, 65 Ga. App. 301, 305, 16 S.E.2d 167, 169 (1941)).

standard contemplates award of an amount representing the value to the individual owner.[155] In contract cases, in contrast, once cost to repair is denied, courts invariably award the diminution in fair market value.

V. A PROPOSED STANDARD

A. DETERMINING FULL COMPENSATION: CONTRACT V. TORT

The primary aim of any contract remedy is to ensure full compensation to the injured party. In the cases arising from defective or incomplete construction, determining with precision the extent of actual injury to the owner — the amount both necessary and sufficient to fully compensate for the loss in value from the breach — is problematic. As the Supreme Court has observed, "[t]he value of property springs from subjective needs and attitudes;"[156] its value to the owner may therefore differ widely from its value to others or to the marketplace. Similarly, when a contractor defectively performs a contract for construction services, the owner may value the loss from receiving the property in a defective condition differently than would others. Placing a dollar figure on that individualized valuation is necessarily somewhat speculative.[157]

As a result, in the defective construction cases arising in contract, courts decline to evaluate the loss to the owner directly and instead use cost to complete and diminution in market value as substitute measures. The *Restatement (Second) of Contracts* invites courts to consider the actual loss to the owner as the primary measure of damages, but requires that the amount of such loss be proved with "sufficient certainty," making the rejection of actual loss to the owner virtually inevita-

155. *See, e.g.,* Heninger v. Dunn, 101 Cal. App. 3d 858, 864-66, 162 Cal. Rptr. 104, 108-09 (1980) (award of $241,257 to replace trees and undergrowth unreasonable but trial court erroneously denied all recovery because market value of land rose; remanded for determination of loss to owner).

156. Kimball Laundry Co. v. United States, 338 U.S. 1, 5 (1949).

157. *See* 5 A. CORBIN, CORBIN ON CONTRACTS § 1004 (1964); Eisenberg, *The Responsive Model of Contract Law*, 36 STAN. L. REV. 1107, 1164 (1984); Farnsworth, *supra* note 1, at 1167. Indeed, it is probably impossible to identify true subjective value, just as it is impossible to determine real subjective intent. *See* Dalton, *An Essay in the Deconstruction of Contract Doctrine*, 94 YALE L.J. 997, 1039-66 (1985). What we seek to do, instead, is to use objective criteria to suggest a likely valuation of worth to the individual owner. For example, we might consider to what use the owner would put the completed construction and at what cost a functionally equivalent facility could be obtained. Or we look at cost to complete or diminution in fair market value as indicators of likely subjective value.

ble.[158] In the comparable tort cases, by contrast, courts attempt to determine the amount that represents the actual value of the loss to the owner instead of simply choosing between cost to repair and diminution in market value, though the factfinder often uses both of those measures to assist in determining the actual loss. The focus on loss to the owner appears to lead those courts to reject less frequently the owner's interest in repairing the property.

The difference between tort and contract formulations in these cases derives from the traditional reluctance of courts in contract cases to permit the kind of flexibility routinely available in selecting damage amounts in tort cases.[159] One possible explanation for this distinction is that contract cases generally involve claims that are more readily ascertainable with precision, because they arise from commercial transactions where commercial loss defines the injury. Tort cases, on the other hand, often involve claims of personal injury, which do not have precisely defined monetary equivalents. More flexibility in proving damages is necessary in order to provide tort plaintiffs with opportunity to recover compensation for loss other than out-of-pocket expenditures. But this difference between the usual tort and contract cases does not apply to the damage analysis in the cases considered here. In the contract cases, the aim is to put the injured party in as good a position as if the contract had been performed; in the tort cases, the goal is to put the injured party in as good a position as if the injury to the land had never occurred. All of these cases may be viewed as simply trying to value the difference to the owner between having the affected property in one condition and having it in another condition. If the owner holds the property for commercial use or resale, the injury can be readily quantified, whether the case sounds in contract or in tort. If the owner holds the property for her own use, the injury is equally difficult to quantify, whether the injury arises from a breach of contract or a tortious act.

158. RESTATEMENT (SECOND) OF CONTRACTS § 348 (1979). I have not found a case in which a court attempted to award damages based on "loss in value to the injured party" proved separately from cost to complete or diminution in value.

159. *See id.* § 352 comment a; C. MCCORMICK, HANDBOOK ON THE LAW OF DAMAGES 97-99 (1935); Washington, *Damages in Contract at Common Law*, 47 L.Q. REV. 345, 366 (1931). Washington suggests that convenience rather than any fundamental difference between contract and tort is the basis for the greater demands on proof in contract cases.

Alternatively, more flexibility — and possibly higher damage awards — might be considered appropriate in tort cases because the injured party was an "innocent bystander," while in contract cases the owner voluntarily entered the contractual relationship. The unsuspecting tort plaintiff is undoubtedly a more sympathetic figure. Simply entering a contract, however, should not mean that the owner thereby assumes the risk of undercompensation upon breach; indeed, the inclusion of specifications in the contract probably leads most owners to think they have protected themselves against this kind of injury.

Because the damages inquiry is similar in all these cases, no matter what the cause of action, and because the tort standard focuses more directly on the actual loss in value to the owner, one might conclude that courts considering contract damages should adopt the approach taken in the tort cases. Courts would then receive all evidence relevant to a determination of value and permit the factfinder to select an appropriate damage figure as long as it did not exceed the greater of cost to complete or diminution in market value.

There are some reasons, however, to caution against use of the same approach in contract and tort cases. In Part IV, this Article suggested that the open-ended nature of the standard that courts use in contract cases permits them to use the market and their own subjective notions of value to determine whether the owner should receive cost to complete. Under the more flexible tort standard, which permits a court to select any amount it believes represents the actual loss in value to the owner, subjective value can play an even greater role. In addition, when the factfinder has complete discretion, it will frequently select a compromise damage award, simply picking an intermediate value between cost to complete and diminution in market value.[160] Because the court may not share the values of

160. This appears to be what the district court jury did in the *Peevyhouse* case. *See supra* notes 16-21 and accompanying text. The Peevyhouses introduced only evidence of a $29,000 cost to complete, while Garland Coal & Mining showed that diminution in value would amount to $300. The jury awarded $5,000, which conformed to neither measure of damages. Many of the torts cases appear to have resulted in such compromise jury verdicts. *See, e.g.*, Mayer v. McNair Transp., Inc., 384 So. 2d 525, 526-27 (La. Ct. App. 1980) (market value of home destroyed by fire was no greater than $57,000; cost to replace was $120,000; jury awarded $93,000); Samson Constr. Co. v. Brusowankin, 218 Md. 458, 466-67, 147 A.2d 430, 437-38 (1958) (little or no diminution in market value from removing trees from lot; cost to restore estimated at $5,200 and $7,200 for two plaintiffs; jury awarded $4,000 and $2,500); Schankin v. Buskirk, 354 Mich. 490, 494-95, 93 N.W.2d 293, 295-96 (1958) (defendant's evidence

the owner, any such compromise figure may undercompensate for the actual injury caused. Moreover, a contract remedy should vindicate the owner's interest in enforcing the execution of the contractor's promises to perform according to the contract specifications. Permitting routine selection of a damage figure less than cost to complete will undermine that goal.

The intrusion of subjective valuation is also likely to be more problematic in contract than in tort cases because of the different nature of the completion work that the owner seeks. In tort cases, the owner has suffered some kind of physical damage to property — for example, cracks in the structure of a building, contamination from toxic wastes, destruction of trees, dumping of debris. Because the damage is tangible, the factfinder is more likely to share the owner's sense of injury. Some of the contract cases involve injuries of this kind — inadequate work resulting in construction defects — but the most problematic cases tend to involve aesthetic considerations. When the owner seeks recovery because the contractor failed to regrade land, provided the wrong kind of brick, or built a discolored roof, the factfinder is less likely to share the subjective concerns that define the value for the owner. Consequently, there is greater danger that the factfinder's own subjective valuations will affect the determination of damages and result in undercompensation for the owner.

These concerns suggest that it would be unwise to shift entirely to a tort standard in determining damages in contract cases. Attempting to award damages based on the actual value to the owner, however, may be appropriate under some circumstances. When courts determine that completion cost is not the proper remedy for breach of a construction contract, they presently turn instead to diminution in market value. Because the

showed no diminution in value from loss of trees; plaintiff's evidence showed cost to replace trees would be $9,000; jury awarded $900); Kirst v. Clarkson Constr. Co., 395 S.W.2d 487, 492-95 (Mo. Ct. App. 1965) (diminution in value of home from damage by nearby blasting shown to be $3,500; evidence regarding cost to repair ranged from $300 to $4,030; jury awarded $1,150). Occasionally, a jury in a contract case will return what appears to be a compromise verdict. *See, e.g.*, Lesmeister v. Dilly, 330 N.W.2d 95, 102-03 (Minn. 1983); Rands v. Forest Lake Lumber Mart, Inc., 402 N.W.2d 565, 569 (Minn. Ct. App. 1987); Douglass v. Licciardi Constr. Co., Inc., 386 Pa. Super. 292, 296-97, 562 A.2d 913, 917 (1989). Under current doctrine, however, those verdicts are generally found not supportable. Thus, the Oklahoma Supreme Court rejected the jury's compromise verdict in *Peevyhouse*, reducing damages to $300, the amount representing diminution in market value. Peevyhouse v. Garland Coal & Mining Co., 382 P.2d 109, 111, 114 (Okla. 1962), *cert. denied*, 375 U.S. 906 (1963).

owner may value the loss differently than does the market, it may be more appropriate for the factfinder, at that point, to evaluate the loss to the owner directly. To do so, the court would have to relax the requirement that the amount of such damage be shown with "sufficient certainty" as that determination is usually understood in contract cases. Instead, the owner would be permitted, as in the tort cases, to use any means available to describe and define the individualized value of the contract performance, including evidence of diminution in fair market value, cost to complete, market value of the property, use of the property, and the reason for desiring the contract performance as promised. The factfinder would then be free to determine an appropriate award, selecting an amount somewhere between diminution in market value — the minimum amount of plaintiff's injury — and cost to complete.[161]

B. CHOOSING THE PROPER REMEDY

In order to select a better rule for determining damages in construction contract cases, several concerns should be addressed. The first is the desire to compensate the owner fully for the injury arising from the breach. At the same time, the rule should avoid overcompensating the owner, which would unfairly burden the contractor with payments not necessary to compensate the injured party. Finally, the standard should, if possible, select an economically efficient remedy.[162]

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161. Several commentators have suggested that such discretion be given the factfinder under some circumstances. *See* Farnsworth, *supra* note 1, at 1175 (if loss in value to owner is uncertain and cost to complete diverges widely from diminution in market value, trier of fact should have discretion to "fix any figure, not unreasonable under the circumstances" between the two limits); Yorio, *supra* note 39, at 1417-18 (if divergence between cost to repair and diminution in value is result of changed circumstances, parties should split the difference).

162. A remedy also might be selected that punishes a breaching party in order to encourage contract performance. In conformity with this approach, several commentators have suggested that, in order to reinforce the moral obligation of contractual promises, cost to complete or specific performance should be awarded whenever a breach is willful or deliberate, even if that results in overcompensation. *See* Yorio, *supra* note 39, at 1408-13; Linzer, *supra* note 39, at 136. Willfulness has been one element leading to a choice of cost to complete in some cases, but no court has based a decision solely on the nature of the breach. *See supra* note 54 and accompanying text. Traditional contract doctrine, on the other hand, rejects a distinction between willful and other breaches. *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS ch. 16 introductory note (1979); 2 E.A. FARNSWORTH, *supra* note 57, § 12.1. Making such distinctions is also problematic because awarding greater damages for willful breaches may in some instances deter efficient breach. *See* Yorio, *supra* note

If the expectation interest of the plaintiff is readily ascertainable, a remedy can be chosen that will satisfy all of these concerns. Whenever the extent of the injury to the owner is difficult to pinpoint, however, there is no assurance that these aims can be met.

The inability to guarantee proper compensation and economic efficiency is particularly likely to occur in the problematic construction contract cases, because the value of contract performance to the owner is so hard to quantify and, as discussed earlier, the determination of damages is especially prone to the intrusion of individual valuation of the factfinder. This statement, in turn, suggests that the best solution may be to select a rule that will lead the parties to make their own choice of remedy when they enter their contract, thus avoiding the need for a court to make what will often be an unsatisfactory choice for them. This Article has argued that the rule most likely to induce the parties to bargain is one that mandates in all cases an award of either specific performance or cost to complete.[163]

It is not clear, however, whether the resulting increase in negotiating costs will offset the benefits to economic efficiency.[164] Moreover, adoption of an inflexible rule mandating specific performance or cost to complete does not guarantee that the parties will negotiate their own solution. The contractor, despite expertise in the field, may not be familiar with the new legal rule or, though knowledgeable, may be unwilling to raise the issue of remedy for breach for reputational reasons. Even if the parties discuss remedies for breach, the contract terms they select may not address all situations that may arise after performance begins, or a court may reject the negotiated clause because of defects in the negotiating process.[165] Under all these circumstances, courts will still employ the default rule

39, at 1409-10. Because this article focuses on a different aspect of the choice of damages — ensuring compensation and recognizing individual value — I have chosen not to enter into the debate about the role that willfulness should play in selection of damage awards.

163. *See supra* Part III.

164. *See supra* notes 101-08 and accompanying text (discussing costs associated with entering into a contract).

165. Because construction contractors generally have more experience in negotiating contracts and determining terms and specifications, as well as more knowledge of industry costs and practices, there is some danger that contractors will overreach in the negotiation process. To guard against this, courts should scrutinize the agreement for signs of overreaching and should at least ensure that, when owners relinquish their right to receive cost to complete damages, they do so knowingly.

to select the measure of damages. If the default mandates specific performance or cost to complete, the result in some cases may be substantial overcompensation to the owner. Furthermore, a court faced with an inflexible standard may avoid what it perceives to be overcompensation by unnaturally interpreting the contract language to find no breach, thus undermining the purpose of the rule.

On the other hand, the present standard leaves significant opportunity for undercompensation if courts reject cost to complete in favor of an award of diminution in market value, because the loss is often of greater value to the owner than to the market. What seems needed, therefore, is a standard that makes an award of cost to complete almost a certainty, but that offers relief from that result under limited circumstances in order to avoid substantially overcompensating the owner or excessively burdening the contractor. Courts should invoke any such exceptions in a manner that protects against the intrusion of the factfinder's value judgments or, at least, requires their articulation. If the rule suggests that full compensation is not warranted, it should provide for damages approximating actual loss in value so that the interest in awarding full compensation can be vindicated.

As the case law already recognizes, cost to complete should be the presumptive remedy. An award of cost to complete comes closest to permitting the owner to obtain the bargained-for performance.[166] In cases of defective rather than simply nonconforming construction, diminution in market value and cost to complete will almost always be commensurate, as buyers of the property are likely to decrease the offering price by the amount required to make the necessary repairs.[167] In most cases of nonconforming construction, where cost to complete may be somewhat higher than diminution in market value, cost to complete still will likely represent a reasonable estimate of

166. Even an award of the full cost to complete may not actually permit the owner to obtain full performance because insufficient funds may remain after accounting for the expenses of litigation. *See, e.g.*, Macaulay, *An Empirical View*, *supra* note 100, at 470.

167. The one exception in the case law is Rands v. Forest Lake Lumber Mart, Inc., 402 N.W.2d 565 (Minn. Ct. App. 1987). In that case, the contractor's expert testified that the value of the house would decrease by a maximum of 20% even if the house reached "incurable functional obsolescence" due to the severity of the defects. *Id.* at 567. In *Rands*, the contractor built a house in which the trusses supporting the first floor were incorrectly designed, creating what the contractor's expert called "a dangerous condition that should be fixed." *Id.* at 568.

owner's loss. There will be some risk of overcompensation, because the owner may value performance at the lower market rate or at some other amount less than cost to complete. The amount of overcompensation, if any, will usually be small, however, and the risk of undercompensation is high if cost to complete is rejected. For that reason, and because certainty of outcome will promote efficiency concerns,[168] the cost to complete remedy should still be favored.

Serious questions about the likelihood of overcompensation only arise when the diminution in market value falls far below the cost to complete.[169] The primary aim of the remedy in such cases is still to provide adequate compensation, so the owner should have the opportunity to demonstrate that cost to complete is the proper measure of injury because she has "personal reasons" for wanting the contract completed as promised and intends to use the award to purchase services to fulfill the contract specifications.[170] The inquiry would be similar to the one conducted under the standard described in the *Restatement (Second) of Torts*, which suggests that an award of cost to repair is appropriate even where it exceeds the entire fair market value of the property, if the owner has a personal reason to perform the repairs.[171] The requirement that the owner intend to spend the award on completing the contract answers the court's fear that the owner will receive a windfall, pocketing the substantial damages because the cost to complete, in fact, exceeds the owner's actual valuation of the injury.[172] If the court finds

168. *See supra* Part III.

169. Typically it is only when the cost to complete or repair is at least one-and-a-half to two times more than the diminution in value that courts question an award of those costs. *See, e.g.*, Peevyhouse v. Garland Coal & Mining Co., 382 P.2d 109, 114 (Okla. 1962), *cert. denied*, 375 U.S. 906 (1963). Awarding cost to complete that exceeds diminution in market value by less than that amount seems appropriate in view of the difficulty of determining loss of value to the owner with exactitude and the consequent danger of undercompensation when cost to complete is rejected.

170. Due to the costs of litigation, an award of cost to complete will usually not actually pay for full completion, so it should be sufficient if the owner demonstrates an intent to use the funds to obtain approximate performance.

171. *See supra* Part IV. Although some contract cases presently reflect a consideration of the owner's reason to complete, it seems to come as an afterthought, rather than as an inquiry central to the determination of the best measure of damages, as it is in the tort cases. *See supra* notes 122-24 and accompanying text (discussing value to owner in tort cases).

172. The fact that an owner might choose to use an award other than to complete the contract does not necessarily mean that the award would be a windfall and overcompensatory. The alternative use of funds might simply offer satisfaction equal to completion of the contract. *See* Birmingham, *supra*

the owner has an honest desire to have the contract completed as promised,[173] then completion is required in order to compensate the owner fully, and courts should almost always award cost to complete.[174]

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note 90, at 66-68. For example, Professor Maute has suggested that, if the Peevyhouses had recovered the $25,000 in restoration costs they sought, they might have used some of the money to pay substantial medical expenses they incurred after entering the contract, despite their desire to see their land restored. Telephone conversation with Professor Judith Maute, University of Oklahoma Law Center (July 8, 1991). That does not by itself rebut the claim that $29,000 is an accurate measure of the injury to the Peevyhouses. Given the risk of overcompensation when cost to complete greatly exceeds diminution in market value, however, it seems preferable to mandate an award of cost to complete only when the owner is prepared to use the money for that purpose — as long as the factfinder is otherwise permitted to select a damage amount greater than the diminution in value.

173. *See* Advanced, Inc. v. Wilks, 711 P.2d 524, 525-27 (Alaska 1985) (factfinder should decide whether the owner is likely to actually complete performance or is only interested in obtaining the best immediate economic condition). Even if the owner asserts a reason to complete the contract, a court may not believe that the owner honestly desires completion. That result would have been likely in *Jacob & Youngs*, where it appears that the specification of Reading pipe was placed in the contract in order to ensure the quality of the pipe, not because Reading pipe itself was required. *See supra* notes 3-15 and accompanying text. The use of equivalent pipe would therefore have fulfilled Kent's expectations and the rationale for including the specification of Reading pipe. Kent never asserted a reason for wanting Reading pipe, and the language with which Reading pipe was specified would probably have belied any reason he gave at the time of trial. *See supra* text accompanying note 4.

If the owner arranged for completion of the contract before the time of trial, the court should assume that the owner honestly desired completion and be particularly reluctant to overcome that showing with the exceptions described in text. Allowing full recovery whenever the owner has already paid for completion may theoretically encourage expenditure of sums greater than necessary to compensate the owner. That is, knowing that she can quarantee an award of cost to complete simply by spending the money before trial, an owner might decide to arrange for completion even though she does not value the contract breach so highly. In practice, however, the risk of recovering nothing because of failure to prove breach at all or because of difficulties collecting a judgment will probably deter such strategic behavior.

174. I propose two narrow exceptions to an invariable award of cost to complete under those circumstances. The primary one, related to the burdens of the high award on the contractor, is outlined below. *See infra* notes 176-83 and accompanying text. In addition, there may be some overriding public policy that justifies a rejection of cost to complete. *Cf.* Kimball Laundry Co. v. United States, 338 U.S. 1, 5 (1949) (government in eminent domain case need not pay the owner for his idiosyncratic attachment to the land, because losing such nontransferable values through eminent domain proceedings is a "burden of common citizenship"). For example, if Kent had chosen Reading pipe because the company refused to hire minorities, a court might reject an award of cost to complete because it did not wish to facilitate discriminatory conduct. Courts, however, should not reject completion, as they sometimes now do, simply because they believe completion would be a waste of private resources, be-

Courts may reject cost to complete if the owner does not intend to complete performance or if the factfinder does not believe that the owner plans to complete. In that event, courts should attempt to award damages as do the tort cases, measuring the actual loss in value to the owner, not limited to loss in market value.[175] In addition to considering the owner's reason for including the specification at issue, the cost to complete, the diminution in fair market value, and the market value and use of the property, as courts currently do, courts also should consider — and award damages to pay for the cost of — any actions short of full completion that might ameliorate the injury or partially satisfy the owner's desire for the specified performance. In *Peevyhouse*, for example, some significant restoration might have been possible at a cost lower than the full cost to complete, but higher than the diminution in market value.[176]

Although the owner should ordinarily receive cost to complete after demonstrating that she intends to complete the contract, the right to receive full compensation should be balanced against the burdens such an award may place on the contractor. Because the owner seeks compensation for an unusually high valuation of performance compared to the market, it seems fair to limit recovery when the award would have an unreasonably harsh impact on the contractor. Concern for the effect on the contractor may be an unarticulated aspect of courts' present rejection of cost to complete as constituting economic waste. Nevertheless, any rejection of cost to complete based on balancing the contractor's interests — any definition of what constitutes

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cause that conclusion remains too subjective. Instances of overriding public policy should be rare.

175. The court might also consider the alternative of awarding reliance or restitution damages. Because in most cases the owner retains ownership of the defectively constructed property, these forms of damage award will rarely be appropriate. There are, however, a few unusual cases in which a court has chosen such an alternative. *See, e.g.*, Levan v. Richter, 152 Ill. App. 3d 1082, 1086-89, 504 N.E.2d 1373, 1377-78 (1987) (court awarded $3,048 to restore site of defective swimming pool to pre-contract condition instead of $25,000 cost to rebuild pool); Crescent Coating Co. v. Berghman, 480 So. 2d 1013, 1019 (La. Ct. App. 1985) (where construction so defective that it is useless, court should award price paid for construction and cost to remove construction and restore land to original condition); Caubarreaux v. Hines, 442 So. 2d 898, 901 (La. Ct. App. 1983) (at owner's request, court awarded $16,795 to pay for dismantling of defective swimming pool and regrading of land; replacement of pool would have cost additional $15,100), *application denied*, 446 So. 2d 1225 (La. 1984).

176. *See* Diodene v. Blueridge, Inc., 480 So. 2d 446, 448, 451 (La. Ct. App. 1985) (to compensate for water leakage on slab supporting house, court rejected full cost to rebuild slab but awarded $1000 to cut drainage trough through slab and $500 aesthetic damage from presence of trough).

"unreasonably harsh impact" warranting relief — should be limited to narrow and well-defined circumstances to avoid the difficulties the current rule presents.

One promising avenue for providing definition to this exception is to allow the contractor the opportunity to demonstrate that completion of the contract is commercially impracticable.[177] The doctrine of commercial impracticability is used to excuse a party from contract performance when changed circumstances have altered performance obligations considerably and made compliance extraordinarily more costly than the parties originally contemplated. In order to obtain relief, a party must demonstrate that performance has become both expensive and financially destructive, and that the party neither caused the change in circumstances nor bore the risk of change under the terms of the contract.

As in the cases raising commercial impracticability, the cost of performance in the construction contract cases is high and the burden on the contractor severe because circumstances have changed since the contract was entered. The cost of performing according to specifications after the breach has occurred is typically much higher than originally planned, either because completion now requires undoing of work already completed[178] or because subsequent events make predictions about the cost of the work incorrect.[179] Thus, the contractor should

177. *See generally* 2 E.A. FARNSWORTH, *supra* note 57, § 9.6. Several commentators have suggested the use of impracticability analysis, but only with respect to cases such as *Peevyhouse*, in which external conditions proved to be different than predicted. *See* Yorio, *supra* note 39, at 1413-16; Linzer, *supra* note 39, at 136. The suggestion made here is that almost all the construction cases are cases of claimed impracticability.

178. *See, e.g.,* Salem Towne Apartments, Inc. v. McDaniel & Sons Roofing Co., 330 F. Supp. 906, 909 (E.D.N.C. 1970) (discolored shingles on roof of apartment block); Eastlake Construction Co. v. Hess, 102 Wash. 2d 30, 36, 45, 686 P.2d 465, 468, 473 (1984) (en banc) (non-conforming insulation beneath completed concrete floor); Jacob & Youngs, Inc. v. Kent, 230 N.Y. 239, 240-41, 129 N.E. 889, 890 (1921).

179. *See, e.g.,* Rhode Island Turnpike & Bridge Auth. v. Bethlehem Steel Corp., 119 R.I. 141, 163, 379 A.2d 344, 356 (1977) (paint placed on bridge parts during manufacture was defective; repainting bridge after construction completed would be much more expensive). Similarly, in Peevyhouse v. Garland Coal & Mining Co., 382 P.2d 109 (Okla. 1962), *cert. denied*, 375 U.S. 906 (1963), the coal company argued (in a brief filed after the court decision) that the coal seam was deeper than anticipated so that mining activity ceased earlier than planned and reconstruction work thereby became more costly. Recent research suggests, however, that there may have been no factual basis for this assertion. In fact, the increased cost of restoration may have been the result of an error by Garland in estimating the placement of the mining pit in relation

be entitled to relief by fulfilling the requirements of excuse for impracticability.

One variation from standard impracticability analysis is necessary, however. In the construction cases, the contractor almost always causes the change in circumstances by performing the work defectively and sometimes by failing to discover the defects until surrounding work has been completed. If the contractor is barred from relief by being thus at fault, courts will never relieve the contractor from paying completion costs. As an alternative, it seems sufficient that the court consider how and why, rather than simply whether, the contractor is at fault in causing the increase in cost. For example, courts should be more reluctant to excuse a contractor who acts willfully[180] or who discovers or is informed of defective performance but proceeds to complete additional work, making the cost to repair significantly higher.[181]

One of the requirements for excuse for impracticability is demonstrating that the party did not undertake the risk of the changed circumstances. The contractor should therefore be required to show that the contract did not allocate to the contractor the risk of liability to complete performance of the contract at substantially greater cost than originally contemplated. For example, the price of the construction may be set at a level that allows the contractor to pay substantial costs for redoing work on a single project while still retaining a reasonable profit margin on that project or in the business as a whole.[182] Or the original bargain itself may reflect that the contractor assumed the obligation to perform costly work to complete.[183]

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to the Peevyhouse property lines. Telephone conversation with Professor Judith Maute, University of Oklahoma Law Center (July 8, 1991).

180. *See supra* note 54.

181. *See* Grossman Holdings, Ltd. v. Hourihan, 414 So. 2d 1037, 1038 (Fla. 1982), *remanding* 396 So. 2d 753 (Fla. Dist. Ct. App. 1981).

182. In cases of excavation for mining, for example, a mining company might set royalties at a level designed to compensate for ordinary reclamation and the occasionally extraordinarily expensive reclamation.

183. For example, in Groves v. John Wunder Co., 205 Minn. 163, 286 N.W. 235 (1939), the contract included the lessee's substantial payment for the right to remove gravel from the owner's land as well as a promise to level the land afterwards. *Id.* at 164, 286 N.W. at 235. The owner argued that the cost of the levelling was part of the calculation of the original contract price; without that promise, the lessee's payment would have been higher. Such an arrangement would constitute the lessee's assumption of the risk. In her recent research on the *Peevyhouse* case, Professor Judith Maute has discovered that the mining contract there also reflects a recognition of the costs of restoration. Garland's standard contract provided for a $3000 advance payment to the property owner

The foreseeability that the owner would desire precise performance of the particular contractual promises should also play a part in determining whether the contractor took the risk of high damages from nonperformance. For example, it is generally foreseeable that a homeowner will be greatly concerned about the nature of the exterior covering of the home, so that a substitution of common brick for face brick would give rise to demands for full performance. In contrast, a contractor in the position of Jacob & Youngs likely would not foresee that the homeowner would have a particular concern that only Reading pipe and not an equivalent pipe be used in his home, at least in the absence of any communication from the owner of a reason, other than assurance of quality, for selecting the brand of pipe. If the owner's concerns with precise performance are foreseeable, it is reasonable to conclude that the contractor assumed the risks associated with failing to comply with the contract terms, in part because the contractor could have taken greater care to perform according to specification those terms that, predictably, the owner would find of special importance.

If, as a result of this analysis, courts reject cost to complete because of the burden on the contractor, they should not simply award the owner the diminution in market value. Instead, courts should consider all the factors used to determine the value of the loss to the owner, as well as evidence related to the claim of impracticability, and choose a damage award that will compensate the owner at the highest level consistent with fairness to the contractor.

Part II of this Article criticized the standard that courts currently employ as permitting the intrusion of the factfinder's subjective valuation into the decision whether to grant cost to complete damages. Clearly, the approach suggested here does not prevent such intrusion, as it explicitly invites courts to conduct an open-ended inquiry into the hard-to-quantify valuation

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for surface damage. The Peevyhouses declined to receive this amount in favor of the restoration clause inserted in the contract. Telephone conversation with Professor Judith Maute, University of Oklahoma Law Center (July 8, 1991). *See also* City of Anderson v. Salling Concrete Corp., 411 N.E.2d 728, 731-34 (Ind. Ct. App. 1981) (city leased land for use as landfill for $1 per year, with obligation to fill land until level; court awarded $181,200 diminution in value rather than $590,731 cost to complete without considering whether $1 landfill rental reflected high costs of providing fill); American Standard, Inc. v. Schectman, 80 A.D.2d 318, 323-24, 439 N.Y.S.2d 529, 533 (1981) (although the grading of property was more difficult than anticipated, defendants must perform task because performance was part of consideration for plaintiff's sale of machinery to defendants).

of contract performance and to balance compensation for the owner with burdens on the contractor. The suggested approach nonetheless limits the discretion that leads to subjective valuation. The initial question courts will address is not whether the *court* views the expenditure as justified but whether the *owner* does. Courts will also address directly the issues of fault and the relative burdens on the contractor and owner of different forms of relief rather than implicitly deciding those questions under the vague rubric of economic waste. Moreover, if courts permit the award of amounts falling between cost to complete and diminution in market value, they will more closely approximate the owner's loss in situations in which cost to complete appears to overcompensate.

VI. CONCLUSION

Selecting the appropriate measure of damages in defective construction contract cases is a recurring problem in both case law and scholarly literature. Courts have chosen to apply a flexible standard awarding cost to complete in most cases, but limiting damages to diminution in value when the two measures are widely divergent and the court believes the greater expenditure is not justified. Such a standard is consistent with what has been called neoclassical contract law, which balances the interests of the owner with the burdens on the contractor and tempers them with the court's own perceptions of fairness and justice in contractual relationships.[184]

This approach too easily sacrifices the owner's values to those of the marketplace or the factfinder, and frequently does so in a context — construction work on individual homes — in which private idiosyncratic values are often present and are of particular importance to at least one of the contracting parties. Moreover, because the owner is usually less knowledgeable about the applicable legal rules, the bias in favor of the contractor in hard cases helps to ensure that the parties will fail to negotiate a voluntarily chosen solution to the problem.

This Article suggests a modification to the present approach, proposing a standard that offers greater protection to the owner's interests in obtaining full contract performance or full compensation for the failure to perform, while responding to the need to avoid overcompensation. The proposed rule will encourage private ordering of damage awards, which will bene-

184. *See* Feinman, *supra* note 100, at 1288.

fit both parties to the contract and lead to a more efficient solution to the damages puzzle.