

A construction company contracted with a regional distributor to construct a warehouse and an access driveway at highway level for \$500,000. Shortly after commencing work on the driveway, the construction company unexpectedly encountered a large mass of solid rock. Instead of incurring additional costs to remove the rock formation, the construction company built the access driveway over the rock with a steep grade down to the highway.

The distributor, who was out of town for several days, was unaware of this nonconformity until the driveway had been finished. As built, it is too steep to be used safely by trucks or cars, particularly in the wet or icy weather frequently occurring in the area. It would cost \$30,000 to tear out and rebuild the driveway at highway level. As built, the warehouse, including the driveway, has a fair market value of \$550,000. The distributor has paid \$470,000 to the construction company, but refuses to pay more because of the nonconforming driveway, which the construction company has refused to tear out and rebuild.

If the construction company sues the distributor for monetary relief, what is the maximum amount the construction company is entitled to recover?

- A. \$30,000, because the construction company substantially performed and the cost of correcting the driveway would involve economic waste.
- B. \$30,000, because the fair market value of the warehouse and driveway "as is" exceeds the contract price by \$50,000 (more than the cost of correcting the driveway).
- C. \$30,000, minus whatever amount the construction company saved by not building the driveway at the specified level.
- D. Nothing, because the distributor is entitled to damages for the cost of correcting the driveway.

Explanation:

Compensatory damages for breach of construction contracts

	Before construction starts	During construction	After construction completed
Breach by builder (owner paid)	Owner entitled to cost of completion	Owner entitled to: cost of completion/correction if no undue economic waste OR value of promised construction <i>minus</i> nonconforming construction	N/A
Breach by owner (did not pay)	Builder entitled to: lost profits <i>plus</i> costs incurred OR contract price <i>minus</i> cost of completion		Builder entitled to contract price

When a contract is breached, the nonbreaching party is entitled to recover **compensatory damages**. Compensatory damages can arise, for example, when a builder breaches a contract during construction (ie, **nonconforming construction**). In that case, the **owner's damages** are the **cost of completing or correcting** the nonconforming construction, provided that this would not involve any undue economic waste. One way to recover these damages is to deduct them from the contract price owed by the owner.

Here, the \$500,000 contract called for the construction of a driveway at highway level. The construction company breached that contract by building the driveway over a rock mass with a steep grade that makes the driveway unsafe. The \$30,000 cost to correct the driveway is *not* unduly wasteful since this expense is necessary to safely access the warehouse (**Choice A**). And since the distributor was entitled to deduct that amount from the contract price and pay no more than \$470,000, the construction company can recover nothing.

(Choice B) Compensatory damages attempt to put the nonbreaching party (eg, the distributor) in the same position as if the contract had been performed as promised. Therefore, the distributor was entitled to deduct his damages for the nonconforming driveway even though the value of the warehouse exceeds the contract price by a greater amount than the cost of correcting the driveway.

(Choice C) If the *owner* breaches a construction contract prior to completion, the builder is entitled to recover the contract price minus whatever amount the builder saved by not

having to complete the construction (ie, the cost of completion). But here, since the *builder* (ie, the construction company) breached, it is not entitled to recover any amount, and it is irrelevant how much was saved by not building the driveway at the specified level.

Educational objective:

If a builder breaches a contract during construction, the owner can recover the cost of completing or correcting the construction if it involves no undue economic waste.

References

Restatement (Second) of Contracts § 348 (Am. Law Inst. 1981) (explaining that the measure of damages for defective construction is the cost of completion as long as it is not clearly disproportionate to the loss in value).

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