

A homeowner and a contractor entered into a contract for the construction of a home for \$300,000. The contractor was to earn a profit of \$10,000 for the job. After the contractor had spent \$45,000 on labor and materials, including \$5,000 on oak flooring not yet installed, the homeowner informed the contractor that the homeowner had lost her job and could not pay the contractor for his services. The homeowner told the contractor to stop working immediately.

The reasonable market value of the labor and materials provided by the contractor at that point, including the oak flooring, was \$40,000. The contractor used the oak flooring on another job.

In an action by the contractor against the homeowner for damages, which of the following would be the largest amount of damages recoverable by the contractor?

- A. \$40,000, the contractor's construction costs.
- B. \$40,000, the reasonable value of the services the contractor had provided.
- C. \$50,000, the contractor's construction costs of \$45,000 plus the \$10,000 profit minus the \$5,000 saved by reusing the oak flooring on another job.
- D. \$55,000, the contractor's construction costs of \$45,000 plus the \$10,000 profit.

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

Compensatory damages are intended to place the nonbreaching party in the same position as if the contract had been performed (ie, give that party the benefit of the bargain). Where an **owner breaches** a construction contract **before or during construction**, the **builder is entitled** to recover the **profits** it would have earned had the contract been completed **plus costs incurred** up to that point. However, any **costs saved** or otherwise avoided (ie, mitigated) by the builder will be **subtracted** to arrive at the final damages award.

Here, the contractor had spent \$45,000 on labor and materials when the homeowner stopped the work. And the contractor had expected to make a \$10,000 profit for this job. As a result, he would be entitled to recover \$55,000 *except* that he saved \$5,000 by using the oak flooring on another job. Therefore, the largest amount of damages recoverable by the contractor is \$50,000 (\$10,000 expected profit + \$45,000 costs incurred - \$5,000 costs saved) **(Choice D)**.

(Choice A) The contractor's \$40,000 construction costs (\$45,000 costs incurred - \$5,000 costs saved) represent his reliance damages—ie, damages intended to place the injured party in the same position as if the contract had never been entered. But this measure of recovery fails to account for the contractor's \$10,000 anticipated profit.

(Choice B) Restitution damages are measured by the benefit conferred on another party. But here, the \$40,000 amount (reasonable value of the services the contractor had provided) is an incorrect measure of restitution damages since it fails to deduct the \$5,000

worth of oak flooring the contractor used on another job. \$35,000 would be the correct measure, and this represents the *smallest* amount of recoverable damages.

Educational objective:

When an owner breaches a construction contract before or during construction, the builder's damages are equal to the builder's lost profits plus costs incurred, minus any costs saved or otherwise avoided.

References

Restatement (Second) of Contracts § 344 (Am. Law Inst. 1981) (purpose of remedies).

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