

2015

## Rethinking *Jacob & Youngs v. Kent*

Victor P. Goldberg

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### Recommended Citation

Victor P. Goldberg, *Rethinking Jacob & Youngs v. Kent*, 66 Case W. Rsrv. L. Rev. 111 (2015)

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# RETHINKING *JACOB & YOUNGS V. KENT*

*Victor P. Goldberg*<sup>†</sup>

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## INTRODUCTION

Most living lawyers have run into *Jacob & Youngs, Inc. v. Kent*<sup>1</sup> in their legal education. It has long been a staple in Contracts casebooks.<sup>2</sup> While the result has been widely applauded, in recent years there has been some push-back. Professor Kenneth Ching has recently criticized both Cardozo's argument and the result.<sup>3</sup> Professor Robert Scott in a number of papers, some coauthored, has also concluded that the result was wrong.<sup>4</sup> Yet given the state of New York law at the time

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1. 129 N.E. 889 (N.Y. 1921).
2. It is a main case in 24 of 25 Contracts casebooks. The outlier, Macaulay, et al, *Contracts: Law in Action*, has a lengthy discussion of the case at Volume I, p. 198 and Volume II, pp. 398-400.
3. Kenneth K. Ching, *Justice and Harsh Results: Beyond Individualism and Collectivism in Contracts*, 45 U. MEM. L. REV. 59, 62 (2014) (asserting that Cardozo was guilty of "material misrepresentations of fact and law"); *Id.* at 70-71 (footnote omitted) ("Generally, impugning a judge's character should be avoided, but Cardozo's claim that the contract is 'silent' is either negligent or dishonest.").
4. See Jody S. Kraus & Robert E. Scott, *Contract Design and the Structure of Contractual Intent*, 84 N.Y.U. L. REV. 1023, 1095-97 (2009) (stating that "commercial parties have sound reasons for creating express conditions, and thus courts have good reasons to enforce them"); see also Alan

Cardozo's result was correct. Moreover, I will argue, the outcome is one that parties would adopt today. Ironically, despite the usual characterization of New York as being formalistic and having "hard" rules, its "soft" position on one question played a significant role.

The core facts are simple. Kent, a very wealthy lawyer, hired Jacob & Youngs to build a mansion. The contract price was about \$77,000.<sup>5</sup> The contract required that Kent make the final payment of \$3,483.46 upon the architect providing a certificate acknowledging completion.<sup>6</sup> The architect refused to award the certificate because the contract required that all the pipes be Reading Pipe, but a substantial amount of pipes installed were of other brands. The architect ordered that Jacob & Youngs replace the nonconforming pipe even though that would have required tearing down significant portions of the structure at a great cost. The contractor refused to do so, Kent refused to make the final payment, and Jacob & Youngs sued.<sup>7</sup>

In a 4-3 decision, Cardozo held that the contractor had substantially performed and that the mistake was inadvertent. He stated:

We think the evidence, if admitted, would have supplied some basis for the inference that the defect was insignificant in its relation to the project. The courts never say that one who makes a contract fills the measure of his duty by less than full performance. They do say, however, that an omission, both trivial and innocent, will sometimes be atoned for by allowance of the resulting damage, and will not always be the breach of a condition to be followed by a forfeiture.<sup>8</sup>

Cardozo continued: "The willful transgressor must accept the penalty of his transgression. For him there is no occasion to mitigate the rigor of implied conditions. The transgressor whose default is unintentional

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Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541, 615-16 (2003) ("When the parties adopt a sophisticated governance scheme, it is mistaken paternalism for a court to require a promisee to accept substantial performance."); Alan Schwartz & Robert E. Scott, *Market Damages, Efficient Contracting, and the Economic Waste Fallacy*, 108 COLUM. L. REV. 1610 *passim* (2008) [hereinafter Schwartz & Scott, *Market Damages*]; Robert E. Scott, *In (Partial) Defense of Strict Liability in Contract*, 107 MICH. L. REV. 1381, 1384-87 (2009).

5. Record on Appeal at 7, *Jacob & Youngs, Inc. v. Kent*, 129 N.E. 889 (N.Y. 1921), reprinted in 3 RECORDS AND BRIEFS OF LANDMARK BENJAMIN CARDOZO OPINIONS (William H. Manz ed., 2001) [hereinafter Record]. The plumbing subcontract was for \$6,020.50. *Id.* at 114.

6. *Id.* at 8.

7. See *id.* at 6-8 (discussing the circumstances leading to the lawsuit).

8. *Jacob & Youngs, Inc. v. Kent*, 129 N.E. 889, 890 (N.Y. 1921).

and trivial may hope for mercy if he will offer atonement for his wrong.”<sup>9</sup> A finding of substantial performance meant that the contractor would receive the final payment less an allowance: “In the circumstances of this case, we think the measure of the allowance is not the cost of replacement, which would be great, but the difference in value, which would be either nominal or nothing.”<sup>10</sup>

McLaughlin, in dissent, painted a very different picture: “The plaintiff did not perform its contract. Its failure to do so was either intentional or due to gross neglect which, under the uncontradicted facts, amounted to the same thing, nor did it make any proof of the cost of compliance, where compliance was possible.”<sup>11</sup> If the error were minor and inadvertent, he would have found that there had been substantial performance, but the deviation was neither. He rejected the contractor’s claim that the difference in value between Reading pipe and other pipe was either nominal or nothing.<sup>12</sup> The contractor could not substitute something just as good. The dissent quoted at length an 1858 decision, *Smith v. Brady*:<sup>13</sup>

I suppose it will be conceded that every one has a right to build his house, his cottage or his store after such a model and in such style as shall best accord with his notions of utility or be most agreeable to his fancy. The specifications of the contract become the law between the parties until voluntarily changed. If the owner prefers a plain and simple Doric column, and has so provided in the agreement, the contractor has no right to put in its place the more costly and elegant Corinthian. If the owner, having regard to strength and durability, has contracted for walls of specified materials to be laid in a particular manner, or for a given number of joists and beams, the builder has no right to substitute his own judgment or that of others. Having departed from the agreement, if performance has not been waived by the other party, the law will not allow him to allege that he has made as good a building as the one he engaged to erect. He can demand payment only upon and according to the terms of his contract, and if the conditions on which payment is due have not been performed, then the right to demand it does not exist. To hold a different doctrine would be simply to make another contract, and

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9. *Id.* at 891 (citation omitted).
  10. *Id.*
  11. *Id.* at 892 (McLaughlin, J., dissenting).
  12. *Id.*
  13. 17 N.Y. 173 (1858).

would be giving to parties an encouragement to violate their engagements, which the just policy of the law does not permit.<sup>14</sup>

McLaughlin's reference to the uncontradicted facts is misleading. The record contained almost no facts since the trial judge had not allowed any proof. The rejection of those facts was precisely the reason for the Appellate Division's reversal.<sup>15</sup>

The lack of facts was not for want of trying. Plaintiff's counsel would ask: "Do you know X?" Answer: "Yes." Question: "What is X?" Objection. Sustained.<sup>16</sup> This pattern was repeated twenty times. So it is not surprising that the facts were uncontradicted. But the appeal was based on the Appellate Court's finding that the facts (all 20 X's) were wrongly excluded. The reversal was upon a question of law, not facts. McLaughlin just ignored the legal question and was content to rely on his characterization of the limited facts that had made it into the record.<sup>17</sup>

Of course, Cardozo did not have the facts either. Yet unlike the Appellate Division, his decision did not simply remand for retrial. Professor Ching writes:

Cardozo took the extremely aggressive approach of not merely remanding for a new trial, but of directing a verdict in favor of Jacob & Youngs, largely on the grounds that substantial performance had occurred. But how could Cardozo know substantial performance occurred? There was virtually no evidence on this very issue!<sup>18</sup>

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14. *Id.* at 186–187.

15. *Jacob & Youngs, Inc. v. Kent*, 175 N.Y.S. 281, 282 (N.Y. App. Div. 1919) (“[T]he plaintiff offered evidence to establish that all the pipe used in completing the contract upon this building was well-galvanized, lap-welded wrought iron pipe, known as ‘standard pipe’; that it all had the same market value, the same weight per foot, the same thickness of walls, the same internal and external diameter, the same quality of galvanization, the same wearing qualities, and the same external appearance.

Plaintiff also sought to show the trade meaning of the words ‘standard,’ ‘lap-welded,’ and ‘wrought iron.’ In other words, plaintiff sought to prove that every foot of pipe that went into this work was of the same value and quality as that which was called for, and that the only departure from the specifications was that by inadvertence some pipe was placed in the building which was not manufactured by the same maker as that specified.”), *aff’d*, 129 N.E. 889 (N.Y. 1921).

16. For examples of these exchanges see Record, *supra* note 5, at 89–95.

17. Record, *supra* note 5, *passim*.

18. Ching, *supra* note 3, at 74 (footnote omitted).

Actually, there was a factual basis, albeit not in the record. There had been a previous trial. In that trial the judge let the facts in and the jury found for Jacob & Youngs.<sup>19</sup> The trial judge, however, held that “[i]t was error to submit the case to the jury, and for that reason the verdict should be set aside, and also for the reason that it was against the weight of evidence.”<sup>20</sup> There is no indication as to why a second trial was necessary.<sup>21</sup> Perhaps the existence of that factual record was the basis for Kent’s decision to stipulate that a finding for the plaintiff would be dispositive: “[D]efendant hereby stipulates and agrees that if the said order of the Appellate Division be affirmed, judgment absolute shall be rendered against him in favor of the above-named plaintiff.”<sup>22</sup> Cardozo was not being aggressive; he was merely doing what the parties had agreed to.

That only explains why Cardozo could render a final judgment in the case. It does not justify that judgment. The decision raised a number of issues. Why should the plaintiff’s willfulness matter? Why settle for substantial performance? If the law is to find substantial performance, what should be subtracted from the contract price—the value of completed performance, the cost of completion, or something else? Finally, there is the dog that didn’t bark. The contract made the final payment conditional on the architect’s certificate. No certificate, no payment it would seem. Neither Cardozo nor McLaughlin even raised that argument; what happened?

Before moving on to these questions, I should make four observations. First, there was an easier way to get to the result. The specifications included the following: “Where any particular brand of manufactured article is specified, it is to be considered as a standard. Contractors desiring to use another shall first make application in writing to the Architect, stating the difference in cost, and obtain their written approval of the change.”<sup>23</sup> Plaintiff’s brief noted: “Under this provision of the contract, pipe of Reading Manufacture was to be regarded simply as ‘standard’. Plaintiff, having furnished pipe equal in all respects thereto complied with this provision of the contract. Its

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19. Brief for Appellant at 21, *Jacob & Youngs, Inc. v. Kent*, 129 N.E. 889 (N.Y. 1921), reprinted in 3 RECORDS AND BRIEFS OF LANDMARK BENJAMIN CARDOZO OPINIONS (William Manz, ed., 2001).

20. *Id.* at 23.

21. The first trial concluded on June 25, 1918, the second on October 29 of the same year. *Id.* at 21; Record, *supra* note 5, at 24. I could find no indication of what happened in the interim. Nor could I find the record of the first trial.

22. Record, *supra* note 5, at 123; but see Ching, *supra* note 3, at 112 (claiming that there was no such stipulation).

23. Record, *supra* note 5, at 107. See also RICHARD DANZIG & GEOFFREY WATSON, THE CAPABILITY PROBLEM IN CONTRACT LAW: FURTHER READINGS ON WELL-KNOWN CASES 111–112 (2004) (referring to clause 22).

only failure was in inadvertently omitting to get the approval of the architect.”<sup>24</sup> If Jacob & Youngs could prove that the non-Reading pipe met the standard, then its breach was only the failure to get the architect’s written approval. Damages for this failure would be nominal since there would have been no basis for the architect to withhold approval.

Second, in discussing the Restatement (Second) of Contracts illustration in § 229, which is based on *Jacob & Youngs*, Scott & Kraus make this argument:

It is, of course, possible that the drafting was careless or made in ignorance of the legal implications of making a contractual obligation a condition rather than a promise. But such a conclusion would require some objective evidence to override the strong presumption that commercially sophisticated parties such as . . . the contractor, exercise reasonable care in executing their agreements and know or should know the legal implications of the express contractual language to which they agree.<sup>25</sup>

The legal implications depend on both the contract language and the law of the relevant jurisdiction. If, in fact, the pre-existing New York law imposed constraints on the contractual language, the parties should be presumed to have the knowledge of both the contract language and the law.

That leads to the third point. The contract was a standard form contract for the entire country.<sup>26</sup> If the language was inconsistent with New York law, then it had to be interpreted accordingly. That is pretty obvious. It matters, particularly in resolving the nonbarking dog problem. It turns out that New York gave less weight than most other jurisdictions to the architect’s certificate.

Fourth, I, and (I suspect) most contracts professors, had been under the impression that the prominence of Cardozo’s decision was due to its innovative nature and that much of this—the emphasis on willfulness, the substantial performance, the value of performance—was a sharp break from the past. In fact, it was not. As we shall see, the notion of substantial performance of building contracts and the role of willfulness was over fifty years old.<sup>27</sup> New York precedent on the cost

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24. Brief for Plaintiff at 7, *Jacob & Youngs, Inc. v. Kent*, 129 N.E. 889, 890 (N.Y. 1921), *reprinted in* 3 RECORDS AND BRIEFS OF LANDMARK BENJAMIN CARDOZO OPINIONS (William H. Manz ed., 2001).; *see also* ANDREW L. KAUFMAN, *CARDOZO* 351 (1998) (recognizing this alternative).

25. Kraus & Scott, *supra* note 4, at 1096.

26. *See* Record, *supra* note 5, at 19 (“He sues upon a contract, standard printed contract and specifications which form part of the contract.”).

27. *See infra* notes 60–70 and accompanying text (discussing how the substantial performance rule created by *Nolan v. Whitney* became entrenched in New York law).

versus value of completion was skimpier, but it did exist, even though it was not cited in plaintiff's brief.

The legal background will be described in Part I. I begin with the development of the doctrine of substantial performance and the role of willfulness. If the contractor's compensation were conditional on the architect providing a certificate of completion, what happens if the architect refused to provide the certificate? If a court concludes that the work had been substantially performed, how should the contractor's award be modified? In Part II, I revisit *Jacob & Youngs* to show how the result followed from the pre-existing law. That, of course, does not mean that it was a sensible outcome. In Part III, I show that the *Jacob & Youngs* result has, in essence, been incorporated into the standard form building contracts.

## I. THE PRE-JACOB & YOUNGS V. KENT LAW

### A. Substantial Performance and Willfulness

Suppose that a builder erects a structure that does not perfectly comply with the contractual specifications. If the owner rejects it and insists that it be removed, the builder would not be paid and, quite likely, any progress payments would be returned. If the owner occupies the building, courts have generally held that such occupation would not be a waiver of any of the conditions in the contract. *Jacob & Youngs* raised the waiver argument, but it did not go anywhere.<sup>28</sup> The question that arises in such cases is whether the builder should be compensated for its less-than-perfect effort and whether there should be any allowance for the imperfection. If the builder must fully comply, the owner might receive a perfectly acceptable building but use a pretext to refuse to pay.<sup>29</sup> On the other hand, if the builder can ignore the specifications and still get paid the bulk of its fees, its incentives to comply with the contractual specifications are weakened. The doctrinal response to this is the notion of substantial performance.

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28. See Record, *supra* note 5, at 20–21 (acknowledging “that it was conceded at the last trial that taking possession was not waiver”).

29. The builder cannot reclaim any of the materials once they are incorporated into the building.

The owner of the soil is always in possession. The builder has a right to enter only for the special purpose of performing his contract. Each material as it is placed in the work becomes annexed to the soil, and thereby the property of the owner. The builder would have no right to remove the brick or stone or lumber after annexation, even if the employer should unjustifiably refuse to allow him to proceed with the work.

Smith v. Brady, 17 N.Y. 173, 188 (1858).



The common law rule in the early nineteenth century chose the former path. In *Ellis v. Hamlen*<sup>30</sup> Sir James Mansfield rejected the builder's claim.<sup>31</sup> It appears that the builder did receive a substantial amount of money in progress payments and that none was clawed back.<sup>32</sup> So it appears that the owner did not receive the cost of completion; it was just allowed to avoid the final payment. Nonetheless, the opinion was quite clear that there would be no room for an argument of substantial performance.

In 1828 in *Hayward v. Leonard*,<sup>33</sup> the Supreme Judicial Court of Massachusetts held that although the builder failed to perform as per contract, the builder could nonetheless be compensated in quantum meruit.<sup>34</sup> The same issue arose in New York in an 1858 decision, *Smith*

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30. (1810) 128 Eng. Rep. 21, 3 Taunt. 52.

31. The court said the following:

Here the Plaintiff has properly declared on his special contract, and he has shewn and proved that he made such a contract, and has received much money on it. He cannot now be permitted to turn round and say, I will be paid by a measure-and-value price. The Defendant agrees to have a building of such and such dimensions: is he to have his ground covered with buildings of no use, which he would be glad to see removed, and is he to be forced to pay for them besides? It is said he has the benefit of the houses, and therefore the Plaintiff is entitled to recover on a quantum valebant. To be sure it is hard that he should build houses and not be paid for them; but the difficulty is to know where to draw the line; for if the Defendant is obliged to pay in a case where there is one deviation from his contract, he may equally be obliged to pay for anything, how far soever distant from what the contract stipulated for. The Plaintiff accordingly was nonsuited; and the case was never again moved.

*Id.* at 22, 3 Taunt. at 53.

32. *Id.* at 22, 3 Taunt. at 53 (finding that the builder “has received much money on [the contract]”).

33. 24 Mass. (7 Pick.) 181 (1828).

34. *Id.* at 185–87. Technically, the court allowed recovery in quantum meruit for labor and quantum valebant for materials. In a subsequent decision, the court elaborated:

In this commonwealth, . . . a plaintiff who has substantially performed a building contract except in some comparatively slight deviations, or in some slight unessential variations, may recover on a count in quantum meruit if he can show an attempt to perform it with such an “approximation to complete performance that the owner obtained substantially what was called for by the contract, although it may not be the same in every particular, and although there may be omissions and imperfections on account of which there should be a deduction from the contract price.” . . . But it is also the settled law of this commonwealth that an intentional departure or wilful default in the performance of a substantial stipulation of a contract is in itself such

*v. Brady*,<sup>35</sup> the opinion quoted at length in McLaughlin's dissent. The court rejected the restitution route but did hold out a possibility of recovery in certain circumstances for substantial performance. The contract in *Smith* had the same structure as the Kent contract. The owner would make progress payments, and payment was conditional on the architect granting a certificate.<sup>36</sup> The contract price was \$4,900, and the final payment was to be \$2,000.<sup>37</sup> The court appeared quite willing to decide the case on the builder's failure to obtain the architect's certificate:

The parties have seen fit to make the production of such a certificate a condition precedent to the payment. The plaintiff is as much bound by this part of his contract as any other. It is not enough for him to bring his action and say that he has completed the work which he undertook to do. He has agreed that the architects named should decide whether the work is completed or not. He cannot now withdraw the decision of this question from them and refer it to the determination of a legal tribunal.<sup>38</sup>

The referee held that by occupying the structure the owner had waived the certificate condition and that the builder should be paid the contract price less an adjustment to account for the deficiencies. On appeal the waiver argument was rejected.<sup>39</sup> The referee found "that there were 'some omissions and deficiencies in the work and materials which the contract required to be done by the plaintiff, the value of which, or, in other words, the loss to the defendant thereby,' amounted to \$212.57."<sup>40</sup> This position was rejected on appeal:

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bad faith as bars recovery, regardless of the presence or absence of an intent to gain or obtain some advantage thereby.

*Smedley v. Walden*, 141 N.E. 281, 284 (Mass. 1923).

35. 17 N.Y. 173 (1858).

36. *See id.* at 174 ("For this work, which was to be completed before May 1, 1851, the defendant agreed to pay the plaintiff the sum of \$4900, of which a part was to be paid from time to time, as the work progressed, and the balance '*when all the work should be completed and certified by the architects to that effect.*'").

37. *Smith*, 17 N.Y. at 174. There was an additional claim for \$295 for additional work. *Id.*

38. *Id.* at 176.

39. *See id.* ("[W]hether or not the performance of the condition in question was waived was a question of fact to be determined by the referee from the evidence before him, and no such fact has been found by him.").

40. *Id.* at 179–80.

The particulars in which the referee found the contracts not performed are not stated in his report, but they could not have been so unimportant that the law will refuse to notice them, because, in the same report the value of those particulars is ascertained to be over \$200. Nor is it found that the plaintiff intended to perform his contract. For aught that appears, the omissions and defects were intentional and willful, and, in the absence of all explanation, the presumption is that they were so.<sup>41</sup>

This seems to put the burden of proof regarding willfulness on the builder. It appears that the valuation of the deficiencies would have been based on the difference in market value, not on the cost of completion. Some, perhaps all, of the deficiencies were structural, unlike those in *Kent*. The joists were supposed to be twelve inches apart, but they were sixteen inches apart. The difference between the beams was supposed to be sixteen inches, but it was twenty-four inches. The court rejected the builder's argument that the building was good enough.<sup>42</sup> After noting that the "good enough" standard had been adopted in some other states, the court stated:

Indeed, in this state the sanctity of contracts in this respect at least, has been steadily maintained, and no encouragement has ever been given to that loose and dangerous doctrine which allows a person to violate his most solemn engagements and then to draw

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41. *Id.* at 180.

42. Rejecting the builder's argument, the court said the following:

To meet the defence so far as it depended on these particular departures from the contract, the plaintiff was allowed to call other mechanics and ask them as follows: "Are the houses without these deficient joists and beams, sufficiently strong for the character of the buildings?" The evidence was objected to on the part of the defendant, but the objection was overruled, the plaintiff's counsel stating that the object of the inquiry was to ascertain what damages, if any, should be allowed by reason of this deficiency in the work. This ruling of the referee was duly excepted to; and the evidence being given tended to show that the houses were sufficiently strong, that the joists and beams were placed at distances customary in that neighborhood, and that the defendant really was not injured at all by this violation of the contract. The question now to be determined is whether this evidence was proper; and this will, I think, involve the inquiry whether the plaintiff, having failed in substantially performing the contract, was entitled to recover for his work and materials, making to the defendant an allowance for the breaches, to be adjusted according to some principle of equity.

*Id.* at 181.

the injured party into a controversy concerning the amount and value of the benefits received.<sup>43</sup>

The court then made the “Doric column” argument quoted by McLaughlin.<sup>44</sup> Still, the court concluded that slight inadvertent deviations would be tolerated.<sup>45</sup>

Thus, there was at least some possibility that a contractor could recover for substantial performance without relying on restitution. The decision does not make clear whether a finding of substantial performance would trump the failure of an architect to provide a certificate. Nor does it make clear whether the owner could claw back any of the previous payments. Hunter asserts that there was no claw back although the decision says nothing about this.<sup>46</sup>

The substantial performance rule soon became the law in New York. In *Woodward v. Fuller*,<sup>47</sup> an 1880 decision cited by both Cardozo and McLaughlin, the referee found that the “failure was caused by his inadvertence and that of his workmen, and by the want of skill and

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43. *Id.* at 186.

44. *Jacob & Youngs, Inc. v. Kent*, 129 N.E. 889, 893 (N.Y. 1921) (McLaughlin, J., dissenting).

45. The court said the following:

To conclude, there is, in a just view of the question, no hardship in requiring builders, like all other men, to perform their contracts in order to entitle themselves to payment, where the employer has agreed to pay only on that condition. It is true that such contracts embrace a variety of particulars, and that slight omissions and inadvertences may sometimes very innocently occur. These should be indulgently regarded, and they will be so regarded by courts and juries. But there can be no injustice in imputing to the contractor a knowledge of what his contract requires, nor in holding him to a substantial performance.

*Id.* at 190.

46. Hunter asserted:

The suit was for the final payment. The owner had made installment payments as the construction went along, and he was not seeking to have them returned. He simply did not want to make the final payment. Thus, the contractor received at least some of the payment due under the agreement for a performance that was nonconforming, and he saved the expense of buying and installing a large number of joists. The owner received cottages that were nonconforming, but at a price lower than the contract. Whether the court would have followed through on its rule of strict performance and have required the contractor to refund the installment payments had the owner sought that relief is questionable.

HOWARD O. HUNTER, *MODERN LAW OF CONTRACTS* § 11:4 (2015 ed.).

47. 80 N.Y. 312 (1880).

judgment of some of the latter.”<sup>48</sup> The defects were “that the roof and chimneys were not well supported; that folding doors were not well hung, and the casings thereto well fastened; that the tar-paper and clapboards, in some few instances, were not well put on, and one door and casings not fitted so that the door would shut.”<sup>49</sup> The court noted:

It is now the rule, that where a builder has in good faith intended to comply with the contract, and has substantially complied with it, although there may be slight defects caused by inadvertence or unintentional omissions, he may recover the contract price, less the damage on account of such defects.<sup>50</sup>

All these deviations, the court held, could be remedied. It concluded that the builder had substantially performed and that there should be some allowance deducted from the contract price to account for the deviations.<sup>51</sup>

By the time *Jacob & Youngs* was being decided, the gap created by *Smith* had widened considerably. Writing in 1910, Joseph Beale noted: “Where a contractor, performing his contract in good faith, substantially complies with his obligation, but makes some comparatively slight deviations, he may recover compensation for the work done.”<sup>52</sup> The majority position in the United States was summarized in an American Law Report (A.L.R.) article appearing in 1920, the year before *Jacob & Youngs* was decided:

It is generally conceded that the common-law rule requiring a strict or literal performance of a contract has been greatly relaxed in actions on building contracts, so that a builder need only substantially perform his agreement in good faith in order to support a recovery. In such case the builder is entitled to recover the contract price, less a deduction for the damage caused by the omissions or defects. By a “wilful” or an “intentional” departure, as the phrase is used in this note, is meant a departure in bad faith.

#### ***Majority rule***

By the weight of authority a building contractor who wishes to take advantage of the doctrine of substantial performance must

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48. *Id.* at 314.

49. *Id.* at 316.

50. *Id.* at 315–16.

51. *See id.* at 317 (“[A]n allowance out of the contract price will make to the defendant full indemnity.”).

52. Joseph H. Beale, *The Measure of Recovery Upon Implied and Quasi-Contracts*, 19 YALE L.J. 609, 609 (1910).

not be guilty of a wilful or an intentional departure from the terms of his contract. If he wilfully or intentionally departs from the terms of the contract, either in materials or work, he is barred from recovering anything.<sup>53</sup>

Jacob & Youngs was prepared to prove that the pipe was identical in every respect, including price. What if it had shopped and found a batch of Cohoes pipe at a bargain price? Would that have been enough to be labeled willful?<sup>54</sup> I doubt it. Corbin, writing shortly before the case was decided, suggested that it would not.<sup>55</sup>

While the parties in *Woodward* did phase performance, the decision was silent on whether payment was contingent on an architect's certificate. What if the payment were conditioned on the architect providing a certificate and the architect refused? To that question we next turn.

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53. *Wilful or Intentional Variation by Contractor from Terms of Contract in Regard to Material or Work as Affecting Measure of Damages*, 6 A.L.R. 137 (1920).

54. The Restatement (Third) of Restitution uses an illustration based on *Jacob & Youngs v. Kent* in which the contractor substitutes an equivalent product but at a cost saving of \$15,000. It claims that the savings should go to the owner, not the contractor: "The case is not within the rule of § 39 (because Builder's default is unintentional), but principles of unjust enrichment reinforce the conclusion that saved expenditure makes an appropriate measure of contract damages in such a case." RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 39 (AM. LAW. INST. 2011). I find it hard to believe that a court would reach that conclusion. What purpose could be served by imposing a one hundred percent tax on the contractor's efforts to control costs?

55. Corbin observed:

What constitutes substantial performance must be determined with reference to the particular facts in each case. The question is always one of degree and its solution must be doubtful in many cases. If the defendant has himself regarded the deviation as not going to the essence, this will generally be decisive for the court. The ratio of damage done to benefits received will be considered. The degree of moral delinquency on the plaintiff's part will go far to resolve doubts: Has the plaintiff wilfully regarded his contract as a "scrap of paper"? Was his nonperformance intentional but caused by difficulties and hardships? Was his breach an unconscious one? Was he grossly negligent or reasonably prudent? It is frequently said any *wilful* breach on the plaintiff's part will prevent any recovery by him against the defendant. This is altogether too strong a statement. Even while laying down such a principle, the court is nevertheless considering the degree of nonperformance and the degree of moral delinquency.

Arthur L. Corbin, *Conditions in the Law of Contract*, 28 YALE L.J. 739, 761 (1919).

*B. The Lack of an Architect's Certificate*

In *Smith* the court recognized that “[t]o avoid a protracted and expensive litigation, such as this has proved to be, the parties agreed that, in respect to all disputes between them in relation to the work, the architects should be the ultimate arbiters.”<sup>56</sup> The final payment was to be paid “*when all the work should be completed and certified by the architects to that effect.*”<sup>57</sup> The builder had not procured the certificate, but he stated that was “in consequence of the unreasonableness and frivolous objections of the said architects, or one of them, in refusing to give any certificate.”<sup>58</sup> While the referee apparently found this enough to allow him to reject the certificate condition, the court did not. Even so, the court did allow that there could be some circumstances that would allow it to ignore the certificate condition: “Had it been shown by the plaintiff that he had made application to the architects for the requisite certificate, and that they had obstinately and unreasonably refused to certify, it might have been proper, perhaps, for the plaintiff to establish his right to recover by other evidence.”<sup>59</sup> The rule, however, was clear. Barring some extreme circumstances, the certificate condition was binding.

Two years after *Woodward, Nolan v. Whitney* changed the rule.<sup>60</sup> In effect, the court held that if the finder of fact found that there had been substantial performance, the court could infer that the denial of the certificate was unreasonable:

The performance of a building contract need not in all cases be literal and exact to enable the contractor to recover the consideration due upon performance; it is sufficient, if acting in good faith and intending and attempting to perform, he does so substantially. He may then recover, notwithstanding slight or trivial defects for which compensation can be made by an allowance to the other party.

Where the contractor has so substantially performed although by the contract he is bound to procure an architect's certificate of performance to his satisfaction; he may recover without procuring such certificate, upon showing a refusal of the architect to give it; the refusal in such case is unreasonable.<sup>61</sup>

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56. *Smith v. Brady*, 17 N.Y. 173, 177 (1858).

57. *Id.* at 174.

58. *Id.* at 175.

59. *Id.* at 176.

60. 88 N.Y. 648 (1882).

61. *Id.* at 648–49.

The opinion did not give any indication of why it had concluded that the failure to give the certificate was unreasonable. So I turned to an examination of the Record to see if there was an explanation. Unlike in *Jacob & Youngs*, the deficiencies were observable. The owner complained:

[T]he work was to be first-class; but the front walls were bad, the plastering was bad, and the walls were not laid in the kind of mortar (cement mortar) required by the contract. These defects cover the whole work. The defects complained of could not be remedied without taking the walls down and all the plastering off.<sup>62</sup>

The architect testified and was examined by the referee:

Q. I should like to ask if this plastering was such a job as that you would have given or withheld your certificate if he applied for it?

A. I shouldn't have given my certificate without Dr. Whitney's consent, on account of their [sic] being defects to the eye as well as others.

Q. What was your reason for giving that answer that you withheld your certificate until you got Dr. Whitney's consent?

A. Because the work was not finished according to the contract . . . I couldn't conscientiously have given a certificate [the remainder of the answer of the witness is stricken out].<sup>63</sup>

A. Very little variation [of a contract] would prevent me from giving a certificate. I intend in my business to allow no variation—nothing at all. I find no fault with anything except the plastering.<sup>64</sup> I shouldn't have hesitated to give a certificate for anything but the plastering, and for all of that, but the defects I have mentioned—everything else was good.<sup>65</sup>

The referee then awarded the builder his final payment of \$2,700 less \$200 (there were four prior payments).<sup>66</sup>

I do find and decide

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62. Brief for Appellant at 25, *Nolan v. Whitney*, 88 N.Y. 648 (1882).

63. *Id.* at 15.

64. Points for Respondent at 5, *Nolan v. Whitney*, 88 N.Y. 648 (1882).

65. Record at 115, *Nolan v. Whitney*, 88 N.Y. 648 (1882) (on file with the Case Western Reserve Law Review).

66. Points for Respondent, *supra* note 65, at 2, 11.



\* \* \*

Third—That the plaintiff in good faith intended to comply with and has substantially complied with and performed the requirements of said contract.

Fourth—I find that there were trivial defects in the plastering, for which a deduction of two hundred dollars should be made from the said last installment.

\* \* \*

Sixth—That no certificate signed by said architect was ever obtained by plaintiff for the said last installment, for the reason that said architect unreasonably and improperly refused to sign the same.<sup>67</sup>

The trial court affirmed the referee's decision:

The work was entirely, and in good faith, completed. From various causes the last coat of plastering was defective in some particulars. There is no evidence to show that these defects were intentional or designed. Every effort was made to remedy them. It was impossible to do so in some trivial particulars and for this the Referee allowed a deduction of \$200. The allowance of this sum is not evidence that the contract was not substantially performed.<sup>68</sup>

The \$200 adjustment should be kept in mind when we consider the remedy issue in the next Part. The *Nolan* rule became firmly entrenched in New York. The law was described in a brief (one page!) note in the *Harvard Law Review* twenty years after the decision:

American courts have in general shown greater leniency than the English in regard to the performance of express conditions precedent. In no class of cases is this fact better brought out than in suits on building contracts in which payment is to be made only when the architect's certificate is obtained. In England the builder must produce the certificate; he can only excuse himself by proving collusion between the architect and the defendant. In most of our states fraud or gross mistake in withholding the order will entitle the plaintiff to sue on the contract without it. But in New York, if the plaintiff can persuade the jury that he has

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67. Record at 130, *Nolan v. Whitney*, 88 N.Y. 648 (1882) (on file with Case Western Reserve Law Review).

68. *Id.* At 146.

substantially performed the contract he can recover in spite of the architect's disapproval.<sup>69</sup>

This result did not meet with the approval of the author:

But it is conceived that the true rule is that an honest refusal of the architect to give the certificate, no matter how mistaken he may be, debars the builder from suing on the contract. This rule, while mitigating the harshness of the English doctrine, is yet within the fair meaning of the contract. To make it more lenient is virtually to substitute a jury for the architect. To make it more strict is to acknowledge that the latter need not give an honest judgment. Each of these results is equally undesirable, and the decision of the principal case, tending as it does to enlarge the scope of the New York doctrine, is to be regretted.<sup>70</sup>

A possible justification of the New York rule was forwarded one year before Cardozo's *Jacob & Youngs* decision in *Wilson v. Curran*.<sup>71</sup>

The departure of the authorities from the strict application of the rule that, as the architect is the arbitrator, his determination

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69. Note, *Contracts Requiring the Architect's Approval as a Prerequisite to Payment*, 15 HARV. L. REV. 481 (1902) (citations omitted). He continued:

A recent decision in a circuit court of Ohio adopts the New York view. The plaintiff sued on a building contract containing the usual condition of payment upon presentation of the architect's certificate. He did not produce the certificate, and could not prove fraud. The jury found specially that the architect's reason for refusing the certificate was dissatisfaction with the work. The court, on appeal, sustained a general verdict in favor of the plaintiff on the ground that it was not found that the architect's refusal was reasonable.

*Id.*

70. *Id.* at 482 (citation omitted). Another *Harvard Law Review* note, ten years earlier, also recognized the various treatments of the certificate condition:

[P]revention by the defendant of performance of the condition will excuse non-performance. A descending scale of prevention of performance of this particular condition might be thus written: (1) prevention directly by the defendant, or indirectly by his collusion with the architect; (2) prevention by fraud on the part of the architect; and (3) prevention by the unwillingness or unreasonableness of the architect. But of these three, only (1) has the quality of prevention laid in the above rule; namely, prevention by the defendant. Authority and principle agree that (1) excuses non-performance; but on (2) and (3) they part company, (2) being the more conservative rule adopted in this country, and (3) the more general rule.

Note, *Builders' Contracts With Architects' Certificate; The True Ground Of Their Decision*, 6 HARV. L. REV. 201, 202 (1893) (citation omitted).

71. 180 N.Y.S. 337 (1920).

cannot be impeached except for fraud, misconduct, or palpable error on the face of the certificate is due, I think, in part at least, to the fact that in these contracts the architect is employed and paid by the owner. . . . It is a rule growing out of the practical difficulty of the architect's serving two masters, and the milder word 'unreasonable' is under the circumstances preferred by the courts to the words 'constructive fraud.'<sup>72</sup>

*C. Cost Versus Value of Completion*

In *Smith v. Brady* the architect was asked what it would cost to make the building conform to the contract specifications and on the difference in value between the structures as built and what the value would have been had the building conformed to the contract.<sup>73</sup> The referee did not permit the witness to opine on either matter; the court ruled that this was error.<sup>74</sup> The fact that the witness was to opine on both the cost and value of completion suggests that there was no consensus on the appropriate measure of damages. In *Nolan*, as noted above, the referee reduced the contractor's recovery by \$200 (about eight percent of the final payment and two percent of the overall contract price).<sup>75</sup> The Record gave no explanation for this figure, but it is reasonable to infer that the adjustment was based on the loss of value of the building due to the deviation, since the cost of repair would have entailed tearing down the walls.

When *Jacob & Youngs* was decided, the value versus cost of completion question was not a matter of either/or. A 1923 A.L.R. annotation distinguished between two situations, one calling for value and the other for cost: "Where the defects are remediable without taking down and reconstructing any substantial portion of the building, the amount of deduction from the contract price to which the owner is entitled is the expense of making the work conform to contract requirements."<sup>76</sup> If, however, the defect were not remediable, the annotation opted for the difference in value:

Where it is necessary, in order to make the building comply with the contract, and to prevent damage to parts thereof, which would necessitate expensive repairs, that the structure, in whole or in part, be changed, the measure of the owner's damage is the difference between the value of the building as actually constructed and the value it would have had, had it been constructed

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72. *Id.* at 339 (citation omitted).

73. *Smith v. Brady*, 17 N.Y. 173, 177–178 (1858).

74. *Id.*

75. Points for Respondent, *supra* note 65, at 2, 11.

76. Annotation, *Measure of Recovery by Building Contractor Where Contract is Substantially but not Exactly Performed*, 23 A.L.R. 1435 (1923).

in accordance with the contract; since to measure the owner's damage by the sum necessary to make the building conform to the contract would, in many instances, inflict an injustice on the contractor, as it would amount to almost as much as the original contract price.

An intentional departure from, or wilful default in the performance of, a substantial stipulation, is, in itself, such bad faith as will bar recovery, regardless of the presence or absence of an intent to obtain some advantage thereby.<sup>77</sup>

## II. BACK TO *JACOB & YOUNGS V. KENT*

As I noted, neither Cardozo nor McLaughlin mentioned the certificate condition. Professors Schwartz and Scott state that “the builder . . . did not attempt to impeach the architect's decision. Rather, the builder asked a court to hold that perfect compliance was not a condition to receiving the entire last payment; the court agreed.”<sup>78</sup> Given the New York rule, it would not have been necessary to impeach the decision. Nevertheless, contrary to the assertion of Schwartz and Scott, the plaintiff did attempt to argue that the architect had been unreasonable. In the complaint, Plaintiff asserted:

That after the completion by the plaintiff of the work required by said contract, the plaintiff duly demanded of the architect named therein that he issue to the plaintiff his certificate of the completion of the said building and of the amount due to the plaintiff under the said contract and for said extra work and materials, but that the said architect has unreasonably and unjustly failed and refused so to do.<sup>79</sup>

When the plaintiff attempted to introduce evidence about why the certificate was not given, he was rebuffed:

Q. Mr. Youngs, did you subsequent to the receipt of the letters of March 19th, 1915, and November 23rd 1915, . . . and subsequent to the receipt of the letter of January 6th, 1916, have any conversation with Mr. William Wells Bosworth, the architect, under this contract, with reference to granting you a certificate for your work; a final certificate?

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77. Annotation, *Measure of Recovery by Building Contractor Where Contract is Substantially but not Exactly Performed*, 65 A.L.R. 1297 (1930) (supplementing 23 A.L.R. 1435).

78. Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541, 616 (2003).

79. Record, *supra* note 5, at 6.

A. I did.

Mr. Hardon: One moment. It was alleged the certificate was refused. That is the issue, and it appears now that the certificate was refused because of the failure to perform the contract in respect to the plumbing. The witness has so testified. Under those circumstances any conversation between Bosworth and the witness is not binding upon us.

The Court: I will let him say yes or no to that.

The Witness: I did, yes.

Q. What did Mr. Bosworth say to you when you made that request?

Mr. Hardon: Same objection. Objection sustained.<sup>80</sup>

Plaintiff's Brief commented on this exchange:

Mr. Youngs, who had a conversation with the architect relative to the granting of a certificate to the plaintiff, was not permitted to state what the architect said to him concerning the refusal to grant this certificate. It might well be that the architect refused to issue the certificate simply because the owner requested him not to.<sup>81</sup>

Not only did Kent's counsel attempt to keep out testimony regarding the architect's reasons, he appears to argue that the architect's opinions are not relevant. That becomes clearer when he raises an objection during the examination of the architect's assistant:

Mr. Hardon: One moment; that is not an issue in this case and we are not bound by the witness's opinion. He is not one of our employes. He is the employe of Mr. Bosworth: that is all. Mr. Bosworth has no power under this contract to waive any defects, much less has the witness any such power, so nothing he could do could bind us. I object to it as incompetent, irrelevant and immaterial.<sup>82</sup>

If the architect's certificate were a condition of payment, the condition would be binding on the owner as well; the architect would surely have the power to waive any defects if he viewed them as insignificant.

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80. *Id.* at 38–39.

81. Brief for Plaintiff, *supra* note 24, at 6–7 (citation omitted). It is odd that the counsel used “might well be.” If that was what had been said, a less ambiguous phrasing would have been appropriate.

82. Record, *supra* note 5, at 66–67.

Kent's counsel recognized that it was unnecessary to prove the architect's unreasonableness directly: "The absence of a certificate is a complete defence to this action, unless the plaintiff made out a case of substantial performance. Thus the sole issue on the trial was *substantial* performance of the plumbing specifications."<sup>83</sup> The certificate condition, therefore, dropped out of the case. Again, in his brief Kent noted the limited issues on appeal and this did not include the applicability of the certificate condition:

The judgment of the trial Court was reversed 'upon questions of law.' The only questions of law in the case are: (a) Whether on the proofs the plaintiff made out a case of substantial performance; (b) Whether material error was committed by the trial-Court in excluding evidence tending to show that the pipe substituted by the builder for Reading pipe was as good and costly as Reading pipe.<sup>84</sup>

So the certificate condition was off the table. Plaintiff's argument that it had substantially performed emphasized that it could only make that claim if its mistake had been inadvertent and not willful.

The cases of *Smith vs. Brady* (17 N. Y. 173), *Schultze vs. Goodstein* (180 N. Y. 248), and *Spence vs. Ham* (163 N. Y. 220), all have to do with *willful* and *intentional* departures from the contract. Of course, the plaintiff is making no claim here that if it knowingly deviated from the specifications it is entitled to recover.<sup>85</sup>

The Appellate decision emphasized the lack of willfulness:

If this had been done deliberately, plaintiff could not have claimed complete or substantial performance, for it had no right to willfully disregard the provisions of the contract or specifications. But where by inadvertence or mistake a minor deviation has been made, which involves no damage to the defendant, and defendant takes possession of and continues to use the building, without seeking to disturb in any respect the work done by the contractor, the contractor is entitled to prove that he had substantially performed, that the defendant suffered no damage through such innocent mistake, and that what the owner received is what he had the right to expect to get under his contract.<sup>86</sup>

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83. Brief for Appellant, *supra* note 20, at 3.

84. *Id.*

85. Brief for Plaintiff, *supra* note 81 at 17.

86. *Jacob & Youngs, Inc. v. Kent*, 175 N.Y.S. 281, 282 (N.Y. App. Div. 1919).

A strong case can be made that Jacob & Youngs' behavior was not willful given the law at the time. McLaughlin thought otherwise, as did the trial judge in the first trial: "The substitution of other pipe for 'Reading' was not a deviation from the specification. It was a departure and not through inadvertence or mistake, but through inexcusable negligence."<sup>87</sup> The jury in the first trial, on the other hand, found that it was not willful, as did the Appellate court and Cardozo. There seems to be a lot of "proof by adjective." Professor Scott argues that the breach was willful, using Judge McLaughlin's characterization as his basis.<sup>88</sup> There was, he argued, an untaken precaution, namely, the negligent failure to inspect the pipe when it was delivered: "The extraordinary costs of completion in *Jacob & Youngs* resulted from the contractor's failure to inspect the pipe to ensure that it complied with the contract specifications."<sup>89</sup>

However, if we accept the majority's version that there was no difference between the different brands of pipe, then the indifference to brand name of Jacob & Youngs' foreman, the plumbing subcontractor's foreman, and the architect's representative (all of whom did not recognize the non-Reading pipe) is not surprising. The criterion, recall, was that the contractor had acted in bad faith. It is hard to see how the use of the nonconforming pipe could be characterized as bad faith, given precedents like *Woodward v. Fuller*<sup>90</sup> and *Nolan v. Whitney*<sup>91</sup> in which the defects were observable and the court found that the defects reduced the value of the structure.<sup>92</sup>

I have long been puzzled by the role of cost of completion in this decision. As Cardozo noted: "It is true that in most cases the cost of replacement is the measure. The owner is entitled to the money which will permit him to complete, unless the cost of completion is grossly and unfairly out of proportion to the good to be attained."<sup>93</sup> The case is often cited as an illustration of the divergence between the cost and value of completion. Yet the cost of completion did not seem to be an issue. It did not appear that Kent was suing for the cost of completion;

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87. Brief for Appellant, *supra* note 20, at 22.

88. Scott, *supra* note 4, at 1385. He stated: "Virtually all the ensuing commentary has accepted Cardozo's characterization of the contractor's behavior in *Jacob & Youngs* as accidental and has justified the nonwillful characterization of the breach. Unfortunately, however, that characterization appears to be false." *Id.* at 1385-1386.

89. *Id.* at 1386.

90. 80 N.Y. 312 (1880).

91. 88 N.Y. 648 (1882).

92. Both cases were discussed *supra* at notes 47-51 and 60-68.

93. *Jacob & Youngs, Inc. v. Kent*, 129 N.E. 889, 891 (N.Y. 1921) (citation omitted).

he only was defending himself from having to make the final payment. I could not understand why he did not ask for full cost of completion damages, in effect clawing back some of the previous progress payments.

The record provides two answers. First, he did counterclaim for \$10,000.<sup>94</sup> However, the counterclaim was subsequently withdrawn.<sup>95</sup> Second, the contract dealt with the matter. If the contractor failed to perform, the contractor would not be entitled to “further payment[s].”<sup>96</sup> If the owner hired someone to continue the work, the contractor would be liable for those additional expenses; but since Kent did not attempt to replace the nonconforming pipes, the contract limited the contractor’s exposure to the final payment of 5% of the contract price.<sup>97</sup>

The contract did not, therefore, restrict the remedy options to cost versus value. The standard contract at the time capped the contractor’s liability. He would not be able to collect the final payment, but none of the previous payments would be clawed back. If the owner found the defect worth remedying, the cost of that remedy would be charged to the contractor and set off against the final payment. If the owner did not find the defect of sufficient importance to warrant remediation, compensation would either be forfeiture of the last payment or the lost value—although it is not clear whether that would be market value or idiosyncratic value of the particular plaintiff.

McLaughlin noted that the plaintiff had failed to show what it would cost to remove the pipe.<sup>98</sup> While that would have been relevant if replacing the pipe were a realistic possibility, it was irrelevant in this case. The cost of remedying the “error” almost certainly exceeded the final payment. The counterclaim of \$10,000 gives some indication of the cost. In his Brief, Kent acknowledged that repair would not be a

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94. Record, *supra* note 5, at 14.

95. *Id.* at 18.

96. *Id.* at 100.

97. *Id.* at 100–101. The relevant language was in Article V of the contract. *Id.* Article IX of the contract set the final payment at 15%; this was also the case in Article IX of the contract between the contractor and the plumbing subcontractor. *Id.* at 102, 114. There is no explanation of why the 15% hold-back had been transformed into a 5% hold-back. The contractor-subcontractor contract had nearly identical language. *Id.* at 114. If, hypothetically, the deviation could have been repaired for \$2,000 and Kent, in fact, had it done, then the cost could have been shifted to the subcontractor; while the \$2,000 would have been less than 3% of the contractor’s fee, it would have been about one-third of the sub’s fee.

98. *Jacob & Youngs*, 129 N.E. at 892 (McLaughlin, J., dissenting).



“practical thing” since the cost would have substantially exceeded the remaining balance.<sup>99</sup>

The decision gave the contractor his final payment with a possible adjustment to reflect the difference in value. In a per curiam opinion the court held that the appropriate adjustment was zero.<sup>100</sup> So, after almost seven years, Jacob & Youngs was finally paid.<sup>101</sup> Cardozo’s rationale was phrased in rather flowery language that somewhat obscured the reasoning: “Intention not otherwise revealed may be presumed to hold in contemplation the reasonable and probable. If something else is in view, it must not be left to implication. There will be no assumption of a purpose to visit venial faults with oppressive retribution.”<sup>102</sup> He continued:

This is not to say that the parties are not free by apt and certain words to effectuate a purpose that performance of every term shall be a condition of recovery. That question is not here. This is merely to say that the law will be slow to impute the purpose, in the silence of the parties, where the significance of the default is grievously out of proportion to the oppression of the forfeiture.<sup>103</sup>

But, as other commentators have noted, the contract did include those “certain words.”<sup>104</sup>

I think that this can be translated into more mundane language. The court recognized that the owner has an incentive to latch onto any defect or deviation, no matter how trivial, to avoid payment. The court

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99. Brief for Appellant, *supra* note 20, at 11. (“In the case at Bar there was a total failure to offer any such proof, and the reason is not far to seek. With the progress of the European War all plumbing costs, both wages and supplies, were mounting to unprecedented heights. The same was true of all other costs which would have been incurred in restoring walls, floors, ceilings and tiling. That is why, in the plaintiff’s words . . . it was not a ‘practical thing’ for it to complete performance. The cost would have far exceeded the trifling balance remaining unpaid on the contract.”).

100. *Jacob & Youngs v. Kent*, 130 N.E. 933, 230 N.Y. 656 (1921) (“The law . . . restricts the remedy to damages.”).

101. *Jacob & Youngs* completed the work in June, 1914. *Jacob & Youngs*, 129 N.E. at 890.

102. *Id.* at 891.

103. *Id.*

104. *See Ching*, *supra* note 3, at 70–71 (“The contract explicitly stated that if Jacob & Youngs failed to perform, it could lose its right to further payment.”); Peter A. Alces, *On Discovering Doctrine: “Justice” in Contract Agreement*, 83 WASH. U. L.Q. 471, 488 (2005) (referring to dictum in Cardozo’s opinion that allows parties to indicate “by apt and certain words” that “every term shall be a condition of recovery”).

will reject the owner's position if it believes that the deviation claim is opportunistic or strategic. There are tradeoffs. If the courts were to routinely find substantial performance, owners would find it more difficult to satisfy their idiosyncratic preferences—the Doric columns of *Smith v. Brady* and McLaughlin's dissent.<sup>105</sup> But what if the courts erred in the other direction? Contractors might have to incur greater costs to make it less likely that an insignificant deviation would result in a substantial loss. In this particular case, the extra costs (monitoring the pipes identity as they arrived) would have been trivial, as Schwartz and Scott noted.<sup>106</sup> But Kent could have picked other nits and the contractor would have had to be concerned with other possible claims of deviations.<sup>107</sup> Cardozo did not say so, in so many words, but I think it is pretty clear that Cardozo believed Kent's claim to be purely strategic and that if Kent had had to testify he would not have been able to produce a reason for why Reading Pipe was important.

### III. THE LESSONS OF *JACOB & YOUNGS V. KENT*

#### A. *Cost Versus Value of Completion*

Courts have generally followed *Jacob & Youngs v. Kent* in dealing with the cost versus value of completion.<sup>108</sup> Schwartz and Scott argue that this is a mistake. They argue that the efficient default rule would

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105. Kent made the argument forcefully in his brief:

The opinion of the Appellate Division is thus far from convincing. If it is law, it is new law. If it is law, *Smith v. Brady*, *Spence v. Ham*, *Schultze v. Goodstein*, and the recent case *Steel S & C. Co. v. Stock* cease to be law. If it is law, provisions in a building contract against alterations in the work or specifications without consent, for the removal or replacement of condemned material, and for full performance and completion of the contract according to its terms, have lost all force and effect. If it is law, builders become an irresponsible class, and owners contracting for what they want can be compelled to pay for what they do not want.

Brief for Appellant, *supra* note 20 at 20.

106. Schwartz & Scott, *Market Damages*, *supra* note 4, at 1615.

107. There was some evidence that Kent was dissatisfied with the job and was searching for a reason to not make the final payment. See Danzig & Watson, *supra* note 23, at 113 (indicating that Kent was dissatisfied).

108. See Josh M. Leavitt and Daniel G. Rosenberg, *Toward A Unified Theory of Damages in Construction Cases: Part I—Navigating Through the Diminution of Value vs. Cost of Repair Debate in Defect Cases and Allocating Burdens of Proof*, *The Am. C. of Construction Law. J.*, 2 No. 1 (2014) (stating courts favor the costs of repairs over cost of completion). See also John P. Ludington, *Modern Status of Rule as to Whether Cost of Correction or Difference in Value of Structures is Proper Measure of Damages for Breach of Construction Contract*, 41 A.L.R. 4th 131 (2015) (originally published in 1985).

be to award the cost of completion even in cases in which it greatly exceeds the value of performance. Their concern, like that of Kent's counsel, above, is that a lesser remedy would not give the contractor adequate incentives: "But a prepaid seller's incentive to invest efficiently in cost reduction is materially reduced if her damage exposure for failing to invest is capped by the market delta. Cost-of-completion damages in these cases thus function as an efficient deterrent against this moral hazard."<sup>109</sup>

Schwartz and Scott argue that the market value (or market delta, in their terminology) test is a free-floating standard, too vague to give the builders appropriate incentives:

The market delta rule lacks predictability because it is a vague standard that is not grounded in particular parties' circumstances. In the economic waste case, a buyer is restricted to diminished value when cost-of-completion damages would greatly exceed the market delta. The extensive case law following *Jacob & Youngs, Inc. v. Kent* further qualifies the economic waste doctrine by requiring that a seller's default be in "good faith." If her breach is willful or in bad faith, the buyer presumably can recover cost-of-completion damages. The instructions to the parties and courts that cost-of-completion damages cannot be "too high" or that parties must behave in good faith and not "willfully" are acontextual and vague: They are not given content either by contract terms or by legal rules that reflect the specific contexts in which parties function. Free-floating standards such as these give parties and courts little guidance. As a result, these standards fail to motivate sellers to take efficient precautions against ex post cost increases, and they encourage strategic breaches whose object is to extort more favorable terms than a party could obtain in the initial contract.<sup>110</sup>

Indeed, they argue that "there is substantial evidence that parties prefer cost-of-completion damages . . . in the construction cases exemplified by *Jacob & Youngs Inc. v. Kent*."<sup>111</sup> As evidence they cite the standard construction contract of the American Institute of Architects. (AIA):

The Contractor shall promptly correct Work . . . failing to conform to the requirements of the Contract Documents, whether discovered before or after Substantial Completion and whether or not fabricated, installed or completed. Costs of correcting such rejected Work, including additional testing and inspections and

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109. Schwartz & Scott, *Market Damages*, *supra* note 4, at 1619.

110. *Id.* at 1662 (footnotes omitted).

111. *Id.* at 1630.

compensation for the Architect's services . . . shall be at the Contractor's expense.<sup>112</sup>

The evidence, however, does not support their claim. Recall that in Kent's contract the liability was capped at the final payment. The modern AIA form they cite spreads the remedy rule over three clauses: 2.4.1, 12.2.1.1, and 12.3.1.<sup>113</sup> The first two require that the contractor bear the costs of repair incurred either by itself or by a replacement chosen by the owner. The third deals with the case in which the defect is not corrected. If the owner accepts the work, "instead of requiring its removal or correction . . . the Contract Sum will be reduced *as appropriate and equitable*."<sup>114</sup> The parties do, it appears, contract into a free-floating standard; in the words of Scott and one of his co-authors, they delegate the task to the back end.<sup>115</sup> That standard entails both a fault (willfulness, inadvertence) aspect and a monetary (market value, idiosyncratic value, cost of completion, perhaps jury whim) aspect.<sup>116</sup> It is restricted to the class of cases in which the cost of completion exceeds the idiosyncratic value of the owner, for otherwise the owner could pay someone else to complete the project and have the original contractor pay. If the deviation were inadvertent, the outcome would likely be market value. The more egregious the contractor's behavior, the greater the potential liability. Whether it would be capped by the final payment, as in the Kent contract, I cannot say. But the use of "appropriate and equitable" suggests that the contractor's liability would increase the more willful or inappropriate its behavior.

In effect this is Cardozo's outcome. Cardozo seemed to suggest that willfulness would be an on/off switch while the form contract suggests

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112. American Inst. of Architects, Doc. A201 § 12.2.1.1 (1997) [hereinafter AIA 1997].

113. *Id.* at §§ 2.4.1, 12.2.1.1, 12.3.1.

114. *Id.* at § 12.3.1. (emphasis added). Schwartz and Scott cite the 1997 version. Schwartz & Scott, *Market Damages*, *supra* note 4, at 1618 n.27. The most recent 2014 revision makes some changes (including the numbering), but the essential features for our purposes are the same.

115. Robert E. Scott & George G. Triantis, *Anticipating Litigation in Contract Design*, 115 YALE L.J. 814, 814 (2006) ("In deciding whether to express their obligations in precise or vague terms, contracting parties implicitly allocate costs between the front and back end. When the parties agree to vague terms (or standards) . . . they delegate to the back end the task of selecting proxies.").

116. *See* Schwartz & Scott, *Market Damages*, *supra* note 4, at 1631 (claiming that the courts routinely award market damages thereby short-changing owners with idiosyncratic taste). *See also* Leavitt & Rosenberg, *supra* note 108, at 24-25 (suggesting that the burden of proof on proving subjective (idiosyncratic) rather than objective (market) losses would be on the owner).

it would be more like a dimmer.<sup>117</sup> The significant point is that cost of completion is the remedy in the normal case in which the costs are actually incurred; the standard appears sufficiently flexible so that cost of completion would also be the remedy if the costs should have been incurred, but for some reason (perhaps liquidity concerns) they were not. When the costs were not incurred because the costs were significantly greater than the benefits (either market value or idiosyncratic tastes), the loss would be restricted to the value unless the contractor's behavior were sufficiently egregious; in that case, the award might be based on the cost of completion.

So contrary to the Schwartz and Scott claim, the market evidence tends to support the *Jacob & Youngs* rule. If some of the defects are correctible but others, like Kent's plumbing, are not, the remedy might entail a mix—completion costs for the remediable elements, value for the others. The casebook standard, *Plante v. Jacobs*,<sup>118</sup> did use such a mix. For cabinet installation and similar problems the homeowner was awarded the cost of completion.<sup>119</sup> But for the wall that was in the wrong place, off by a foot, the court looked to market value and concluded that the misplacement would have no effect on the value of the house.<sup>120</sup>

#### *B. The Architect's Certificate*

The big puzzle for me was what happened to the architect's certificate condition. The foregoing explains how it disappeared from the case. The rule of *Nolan v. Whitney*<sup>121</sup> goes too far. The rule suggested in the venerable *Harvard Law Review* note, cited above, seems far more sensible: “[A]n honest refusal of the architect to give the certificate, no matter how mistaken he may be, debars the builder from

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117. In practice, I doubt that Cardozo would have confined willfulness to the on/off choice; more likely, he would have approved Corbin's sliding scale.

118. 103 N.W.2d 296 (Wis. 1960).

119. *Id.* at 299.

120. *See id.* at 297–98 (“The plaintiff conceded he failed to furnish the kitchen cabinets, gutters and downspouts, sidewalk, closet clothes poles, and entrance seat amounting to \$1,601.95. . . . The defendants especially stress the misplacing of the wall between the living room and the kitchen, which narrowed the living room in excess of one foot. The cost of tearing down this wall and rebuilding it would be approximately \$4,000. The record is not clear why and when this wall was misplaced, but the wall is completely built and the house decorated and the defendants are living therein. Real estate experts testified that the smaller width of the living room would not affect the market price of the house.”). The court did not note whether the owner attempted to introduce evidence regarding any idiosyncratic value. *Id.* at 298.

121. 88 N.Y. 648 (1882).

suing on the contract.”<sup>122</sup> Proof of substantial performance might be relevant in building a case questioning the architect’s honesty, but the focus would have to be on the architect’s motive, not his competence. While *Jacob & Youngs* dealt with the architect’s unreasonable denial of a certificate, there is a symmetric problem—the unreasonable issuing of the certificate to the detriment of the owner. Indeed, if the owner were a one-shot player and the contractor a repeat player, the unreasonable issuance of a certificate might be the more significant problem.<sup>123</sup>

The law in most American jurisdictions embodies the “honest refusal” standard. However, the AIA standard contracts give a bit less deference to the architect. Thus, the standard form for contracts of “limited scope” which would include single family dwellings (A107) makes the architect’s certificate only one of three conditions precedent for final payment: “Final payment, constituting the entire unpaid balance of the Contract Sum, shall be paid by the Owner to the Contractor when the Work has been completed, the Contract fully performed, and a final Certificate for Payment has been issued by the Architect.”<sup>124</sup> Both this document and AIA A201 (the more general building contract) say that the architect certificate is “final and binding.” However, the architect’s decision is not really final; it must be filtered through mediation and/or arbitration if one of the parties desired:

The Architect will approve or reject Claims by written decision, which shall state the reasons therefor and which shall notify the parties of any change in the Contract Sum or contract time or both. The approval or rejection of a claim by the Architect *shall be final and binding on the parties but subject to mediation and arbitration.*<sup>125</sup>

Claims regarding structural items would be subject to mediation/arbitration, but aesthetic or artistic claims would not be: “Any Claim arising out of or related to the Contract, except Claims relating to aesthetic effect . . . shall . . . be subject to arbitration. Prior to arbitration, the parties shall endeavor to resolve disputes by mediation.”<sup>126</sup> So if Kent’s mansion had been built under the modern form contract, the architect’s decision to not produce the certificate would have been subject to

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122. Note, *supra* note 69, at 482.

123. If the owner were a developer, then it too would be a repeat player.

124. *Bauer v. Klement*, 458 N.W.2d 389 (Wis. 1990) (unpublished, at \*1) (citing contract language that mirrors AIA A107); American Inst. of Architects, Doc. A107 § 15.5.1 (2007) [hereinafter AIA 2007].

125. AIA 1997, *supra* note 112, at § 4.4.5. (emphasis added); *See also* AIA 2007, *supra* note 124, at § 21.1 (providing for dispute resolution procedures).

126. AIA 1997, *supra* note 112, § 4.6.1.

mediation and then arbitration.<sup>127</sup> The additional layers of independent third parties make it extremely unlikely that nowadays the issue of architect unreasonableness would make its way to court.

### CONCLUSION

Schwartz and Scott's empirical study suggests that where the cost of completion greatly exceeds the market value of completion, American courts opt for the value remedy. They argue that restricting the buyer to a market value remedy creates a serious moral hazard problem. With a single price the seller (or builder) provides the buyer with two things, the promise to build and the promise to repair. By awarding the value, not the cost, the courts effectively ignore the second promise. A "prepaid seller's incentive to invest efficiently in cost reduction is materially reduced if her damage exposure for failing to invest is capped by the market delta. Cost-of-completion damages in these cases thus function as an efficient deterrent against this moral hazard."<sup>128</sup> Even if the choice were confined to the two extreme measures, I think that the cost of completion in such cases is likely to result in overdeterrence, too much "defensive medicine"—a cost ultimately borne by purchasers. Schwartz and Scott reject that argument.<sup>129</sup> Even if I were wrong about that, the choice should not be so restricted. Cardozo's rule, and the rule spelled out in the basic building contract, is more nuanced. There is ample room for recognizing idiosyncratic values, and courts do have the freedom to take the builder's behavior into account. Willfulness, or some other variant on deliberate misbehavior, gives the court an avenue for confronting the moral hazard problem.

The House of Lords confronted the problem in *Ruxley Electronics & Construction Ltd v. Forsyth*.<sup>130</sup> An in-ground swimming pool was supposed to have a maximum depth of seven and a half feet, but it was only six feet. The evidence showed that the pool was still safe for diving and that the effect on the market value was nil. The Court of Appeal reversed the trial judge and awarded the owner, Forsyth, the cost of reconstructing the pool (£21,560). While their Lordships disagreed over the wisdom of taking Forsyth's subjective preferences into account, they did reinstate the trial judge's decision that gave Forsyth damages for

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127. Both the Kent contract and the subcontractor contract included arbitration clauses, but apparently none of the parties opted for it. See Record, *supra* note 5, at 103–04, 115.

128. Schwartz & Scott, *Market Damages*, *supra* note 4, at 1619.

129. *Id.* at 1665–66.

130. [1996] 1 AC 344 (HL) 366–67 (citing with approval *Jacob & Youngs v. Kent*).

loss of amenity, £2,500.<sup>131</sup> Lord Mustill's opinion explicitly rejected the choice between the two extremes:

[T]here would indeed be something wrong if, on the hypothesis that cost of reinstatement and the depreciation in value were the only available measures of recovery, the rejection of the former necessarily entailed the adoption of the latter; . . . In my opinion however the hypothesis is not correct. There are not two alternative measures of damage, at opposite poles, but only one; namely, the loss truly suffered by the promisee. . . . As my Lords have shown, the test of reasonableness plays a central part in determining the basis of recovery, and will indeed be decisive in a case such as the present when the cost of reinstatement would be wholly disproportionate to the non-monetary loss suffered by the employer. But it would be equally unreasonable to deny all recovery for such a loss. The amount may be small, and since it cannot be quantified directly there may be room for difference of opinion about what it should be. But in several fields the judges are well accustomed to putting figures to intangibles, and I see no reason why the imprecision of the exercise should be a barrier, if that is what fairness demands.

My Lords, once this is recognised the puzzling and paradoxical feature of this case, that it seems to involve a contest of absurdities, simply falls away. There is no need to remedy the injustice of awarding too little, by unjustly awarding far too much. The judgment of the trial judge acknowledges that the employer has suffered a true loss and expresses it in terms of money.<sup>132</sup>

The problems that arise when the cost of performance greatly exceeds the value recur in a variety of legal contexts. Cost of performance is roughly equivalent to giving one party a property rule protection, in Calabresi-Melamed terminology.<sup>133</sup> If the value of performance

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131. See *id.* at 374–75. It appears that the judge just made up the number. Forsyth's counsel did not attack the measure because he wanted to force the Lordships to choose between market value (zero) and cost of completion. Lord Lloyd of Bewick stated:

Forsyth was, I think, lucky to have obtained so large an award for his disappointed expectations. But as there was no criticism from any quarter as to the quantum of the award as distinct from the underlying principle, it would not be right for your Lordships to interfere with the judge's figure.

*Id.* at 374.

132. *Id.* at 360–61.

133. See Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1092 (1972) (discussing property rule protection).



to a buyer is trivial and the seller's cost of performance great, the specific performance remedy gives the buyer great leverage.<sup>134</sup> If a property owner erroneously erects a structure that encroaches by a few inches on the neighbor's property, a rule that allows the neighbor to insist upon removal again gives that party substantial bargaining leverage. Likewise, if a party constructs a multimillion dollar factory on its property that creates a minor pollution problem on a neighbor, granting that neighbor an injunction would give that neighbor the ability to bargain for payments well in excess of the harm it suffers.<sup>135</sup>

If the courts routinely rejected the property rule in such situations, opting instead for a liability rule, that would raise the same sort of moral hazard problem Schwartz and Scott observed. Rather than bargain for an easement, for example, the factory owner could simply build and pay court-determined damages. Courts have had difficulties coping with these problems, sometimes choosing the property rule and sometimes the liability rule. If one ignores questions of fault, intention, or willfulness, the pattern of opinions in these areas would make little sense. The source of the defendant's vulnerability does matter, even if the court does not explicitly acknowledge it. Mark Gergen observed:

In some jurisdictions, the law on remedies for takings, negligence, and nuisance contains a rule that limits damages when property is inadvertently or justifiably taken to the lesser of replacement cost and market value, and that limits damages when property is inadvertently or justifiably harmed to the lesser of repair cost and diminution in market value.<sup>136</sup>

If, however, the taking or harm were advertent or unjustifiable, the "lesser of" rule need not apply. That is where Cardozo, Lord Mustill, and the AIA form contract come out.

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134. *See, e.g.*, *Walgreen Co. v. Sara Creek Prop. Co.*, B.V., 966 F.2d 273 (7th Cir. 1992).

135. *See, e.g.*, *Boomer v. Atl. Cement Co.*, 257 N.E.2d 870 (N.Y. 1970).

136. Mark P. Gergen, *A Theory of Self-Help Remedies in Contract*, 89 B.U. L. REV. 1397, 1418 (2009).