THE LAW OF CONTRACTS

SUPPLEMENTAL READINGS

Class 09

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Contracts

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Steven L. Emanuel

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CONTRACTS

ELEVENTH EDITION

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CHAPTER 10
REMEDIES

ChapterScope

This chapter deals with the different remedies that are available to the nonbreaching and breaching parties to a contract. Key concepts:

- **Equitable relief:** The equitable remedies of ***specific performance*** (an order to render a promised performance) or an ***injunction*** (an order to refrain from doing something) will be directed by the court where certain requirements are fulfilled. Most importantly, it must be the case that ***money damages*** would be an ***inadequate remedy***.
- **Remedies at law (money damages):** Ordinarily, however, in contracts cases the remedy will not be equitable. Instead, the remedy will consist of ***money damages.*** There are three main measures of money damages in contracts cases:
  - □ **Expectation damages:** "Expectation" damages are the ***most common*** remedy. They attempt to put the plaintiff in the ***position she would have been had the defendant performed.*** The plaintiff is awarded: (1) the out-of-pocket costs she has incurred; plus (2) the profit which she would have made had the contract been completed.
    - □ **Reasonable certainty:** Expectation damages may only be recovered if the plaintiff proves them with ***"reasonable certainty."*** When the plaintiff can't do so, one of the two other measures (reliance and restitution) will be used instead.
  - □ **Reliance damages:** "Reliance" damages attempt to put the plaintiff in ***as good a position as she was in prior to the making of the contract.*** This is done by allowing the plaintiff to recover her ***out-of-pocket expenditures*** incurred in performing the contract.
    - □ **When used:** Reliance damages are most commonly awarded when expectation damages are ***too speculative*** to be proved with reasonable certainty. (*Example:* The contract relates to a newly-formed business, and because of the newness we cannot say how much the business would have earned had D not breached.)
  - □ **Restitution:** "Restitution" damages attempt to prevent the ***unjust***

enrichment of the defendant by returning to a plaintiff who has partially performed ***the value of the performance he has rendered to the defendant.***

- □ **When used:** Restitution damages are sometimes awarded when a contract is ***discharged*** for various reasons (e.g., impossibility). They are also suitable where expectation damages are too uncertain to be awarded and reliance damages would not adequately compensate the plaintiff.

■ **Substantial performance:** A plaintiff who has ***"substantially performed"*** (but not fully performed) may sue for expectation damages arising from the defendant's breach of contract. However, the defendant may counterclaim for damages arising from the plaintiff's incomplete performance.

■ **Suits in quasi-contract:** Restitution and reliance damages are frequently awarded in so-called ***"quasi contract"*** suits. These are suits where recovery "on the contract" is unavailable. Two common quasi-contract scenarios:

- □ **Contract is unenforceable.** Quasi-contract is available where a contract is (or later becomes) ***unenforceable*** or ***voidable***. (*Examples:* (1) A contract that violates the ***Statute of Frauds***, but that is partly performed; (2) a contract that is discharged for ***impossibility***.)
- □ **Recovery by breaching plaintiff.** Quasi-contract is available where a ***plaintiff who has committed a "material" breach*** (i.e., a plaintiff who has ***not substantially performed***), has nonetheless performed enough to render some value to the defendant. The suit is sometimes said to be in "quantum meruit." (*Example:* A contractor who only partially completes work on the construction of a building may recover for the value of the partial construction.)

■ **"Duty to mitigate":** A plaintiff loses his ability to recover if he has not made ***reasonable efforts to avoid damages.*** (*Examples:* An employee must try to find another job; an aggrieved buyer must attempt to "cover" by purchasing substitute goods.)

■ **Liquidated damages:** A provision in a contract setting the amount of damages in case of a breach by one of the parties is called a ***"liquidated damages"*** clause. Such clauses are usually enforceable if they are a ***reasonable estimate*** of damages, viewed as of either the time of the contract or in hindsight when the actual loss is known.

I. INTRODUCTION

A. Recovery on and off the contract: In analyzing the remedies available to a party, one crucial distinction must be kept in mind: that between a suit brought ***on the contract***, and a suit brought off the contract, i.e., in ***quasi-contract***.

1. Suit "on the contract": Where the parties have formed a legally enforceable contract, and the defendant (but not the plaintiff) has breached the contract, the plaintiff will normally sue ***"on the contract."*** That is, he will bring a suit for damages for breach of contract, and the terms of the contract will control for purposes of judging the defendant's wrongful conduct, and calculating damages.

2. Suit in "quasi-contract": But in other circumstances, the plaintiff will bring a suit in what is called ***"quasi-contract."*** His damages will normally be based upon the actual value of the performance he has rendered, irrespective of any price set out in the contract. Situations in which a quasi-contractual recovery may be available include those in which:

- the contract is ***unenforceably vague***;
- the contract is ***illegal***;
- the parties are ***discharged*** from the contract because of ***impossibility***, ***impracticability*** or ***frustration of purpose***; and, most important,
- the plaintiff has ***himself materially breached*** the contract.

A fuller discussion of quasi-contractual recovery appears later in this chapter (see p. 335). The material prior to that deals exclusively with recovery on the contract, a fact which you must constantly keep in mind.

a. "Restitution" distinguished: Many writers refer to a quasi-contractual recovery as ***"restitution."*** The term "restitution," however, is also used to denote a certain measure of damages that may be awarded in suits on a contract, namely, the award to the plaintiff of the amount by which his performance under the contract benefited the defendant. In order to avoid confusing these two very distinct uses of "restitution," the term "restitution" will be used here only to refer to this measure of damages in contract actions. "Quasi-contract" will be the term used to refer to recovery off the contract. "Restitution" is discussed *infra*, p. 330.

B. Law/equity distinction: Another crucial distinction to keep in mind is that between remedies at ***law*** and remedies in ***equity***. Equitable remedies for contract breach, and how they differ from legal remedies, are discussed in a separate major section beginning immediately below.

II. EQUITABLE REMEDIES

A. Equitable relief generally: The usual remedy for breach of contract is ***money damages*** awarded by a court to the aggrieved party. However, there are some situations in which money damages cannot adequately compensate the aggrieved party. This may be the case where the damages are ***too speculative*** or uncertain to be calculated, where damages are simply ***not a substitute*** for the defendant's performance of the contract (as where the defendant breaches a contract to sell a particular piece of land to the plaintiff), or where it is likely that a damage award could not be collected. In these situations, it may be appropriate for the court to grant ***equitable relief***.

1. **Unified system:** Historically, equitable relief was granted by an entirely different system of courts (the courts of equity) than was the granting of money damages (which was done by the common-law courts). In America today, however, nearly all states have ***unified*** the common-law and equity courts, so that the same court may award either damages or equitable relief.

2. **Types of equitable relief:** There are two types of equitable relief that are relevant to contract cases. These are ***specific performance*** and ***injunctions***. A decree for specific performance orders the promisor to ***render the promised performance***. An injunction directs a party to ***refrain*** from doing a particular act.

   a. **Illustration of specific performance decree:** The classic illustration of a specific performance decree in a contract case is where the promisor has promised to ***convey a piece of real estate***, and without justification refuses to make the conveyance. The court will ***order her to make the conveyance***. If she persists in her refusal, the court will order the recording office to record the conveyance even without the promisor's participation.

b. Illustration of injunction: The classic illustration of the use of an ***injunction*** in a contracts case involves the employee who has ***breached an employment contract***. In this situation, the court will rarely award specific performance, since, among other difficulties, ordering the employee to perform smacks of involuntary servitude. What the court will often do, however, is to ***prevent*** the employee from ***working for a competitor***.

Example: D, an opera singer, is under a contract to sing for the City Opera company (located in New York City) during the 1999-2000 season. The contract provides that D will not perform for any other opera company in New York City that season. D then announces that she will not perform at the City Opera, and that she will instead perform at the Metropolitan Opera (also in New York City).

City Opera will not be able to get specific performance, i.e., an order compelling D to do the scheduled performances with City Opera. But it *will* probably be able to get an injunction prohibiting D from singing for the Met or any other New York opera company during the season covered by the contract.

i. **Limits:** But there are significant ***limits*** on the injunctive relief likely to be awarded by a court in a personal services case; see *infra*, p. 315.

B. Limitations on the use of equity: Historically, equitable relief in contract cases (as in other cases) was only given where the common-law remedy was not adequate. Courts today impose fewer restrictions on the granting of equitable relief than they did in earlier centuries. Nonetheless, it remains the case that the standard, and preferred, remedy for breach of contract is the common-law award of damages, and that equitable relief will be given only where the common-law remedy is not adequate. There are three principal pre-conditions to the granting of equitable relief in contract actions:

□ ***Money damages*** must be ***inadequate*** to protect the injured party;

□ The contract's terms must be ***definite*** enough to allow the court to frame an adequate order; and

□ The court's task of ***enforcing and supervising*** the relief must not be unduly difficult.

We discuss each of these pre-conditions below.

1. **Inadequacy of damages:** Most importantly, equitable relief for breach of contract will not be granted unless ***damages are not adequate to protect the injured party***. Farnsworth, p. 773. There are a number of reasons for which damages may in a particular case be an inadequate remedy, two of which are as follows:

   a. **Speculative or hard-to-calculate damages:** It may be the case that the injury suffered from a breach of contract ***cannot be estimated with sufficient certainty***. Farnsworth, p. 774.

      i. **Matters of taste:** For instance, the contract may involve matters of ***taste or sentiment***, which make damages hard to fix with any accuracy (e.g., a contract to sell a work of art which has particular sentimental value to the purchaser).

      ii. **Based on unknown future events:** Or, the required performance may ***vary according to not-yet-knowable future events***, perhaps ones many years in the future, in a way that makes computing a single estimate today of future damages very speculative.

      Example: Insurer promises to pay an annuity of $2,000 per month to Insured during Insured's life. Insurer repudiates the contract. Insured will be entitled to an order compelling Insured to keep making the monthly payments for the rest of Insured's life. That's because money damages are not an adequate remedy: it's unknown how long Insured will live, so a one-time award of a single sum cannot accurately estimate Insured's actual damages from the breach.

   b. **Purchase of substitute:** It may be the case that money ***cannot purchase a substitute*** for the contracted-for performance.

      i. **No other available counter-parties:** This can happen, for instance, because no substitute counter-party is available to take the risk that the breaching party was willing to take, such as in a long-term supply contract.

      Example: P and D enter into a contract whereby D is to supply propane gas to P for various residential subdivisions. Although the contract gives P liberal cancellation rights, D is not permitted to cancel the contract unless the subdivisions convert to natural gas. After performing for some time, D refuses to supply any more gas, and purports to terminate the contract. P sues for specific performance, i.e., a decree ordering D to continue supplying the propane.

Held, P is entitled to the decree. Money damages would not be adequate relief. Although propane is currently available from a number of other sources, there is no guarantee that P will be able to find the propane in future years, because of the uncertainty of world-wide energy supplies. Furthermore, evidence shows that P cannot find another propane supplier willing to enter into a long-term supply contract like the contract here. *Laclede Gas Co. v. Amoco Oil Co.*, 522 F.2d 33 (8th Cir. 1975).

ii. **Item is unique:** It may be the case that the ***item*** being sold is ***unique***, so it's not available elsewhere.

(1) **Goods:** In the area of sale-of-goods, for instance, the item might be one-of-a-kind, such as an ***antique***. See *infra*, p. 316, for more about unique goods under the UCC.

(2) **Uniqueness of land:** Similarly, every parcel of ***land*** has traditionally been deemed to be "unique." Consequently, courts have traditionally held (and most still do) that money cannot purchase a "substitute" parcel, and that therefore a contract for the sale of land will be specifically enforced. This subject is discussed further *infra*, p. 314.

c. Other illustrations: Some other situations in which an award of damages is likely not to be adequate include the following:

i. **Forbearance:** If performance consists of ***forbearance***, damages will generally be found to be inadequate. For instance, if the promise is that the promisor will ***not compete*** with the promisee, damages will not be an adequate substitute, and an injunction will often be granted. (See the discussion of injunctions in personal service cases, *infra*, p. 315.)

ii. **Sale of a business:** A contract for the ***sale of a business*** may well fall within the damages-not-adequate category, if it shown that there is no closely comparable business available for sale. Similarly, ***shares of stock*** that would give ***control*** of a business will often fall within this class.

iii. **Patents and copyrights:** ***Patents*** and ***copyrights*** are unique, so that damages concerning these items of intellectual property will not normally be adequate relief. Rest. 2d, § 360, Comment c.

2. **Definiteness:** The court will not give equitable relief (whether a decree of specific performance or an injunction) unless the contract's terms are ***definite enough*** to enable the court to frame an adequate order. Farnsworth, p. 778. The stakes are especially high where an equitable order is involved, because a party who does not follow the order is subject to the punishment of ***contempt of court*** (which is not the case where a party fails to pay a damage award). Therefore, courts require that the rights and obligations of the parties be specified with ***greater definiteness*** if there is to be equitable relief than in the money-damages situation. *Id*.

3. **Difficulty of enforcement or supervision:** The court will not grant equitable relief where there are likely to be significant difficulties in ***enforcing*** and ***supervising*** the order. Farnsworth, pp. 781-82.

    a. **Construction contracts:** The most significant impact of this arises in connection with ***construction contracts***. The difficulties of supervising the performance of highly complex work, and of judging the results, are often greater than the benefits to be gained.

    Example: D contracts to expand and modernize a steel fabricating plant owned by P. Work is not progressing as rapidly as the contract contemplates, and P seeks an order requiring D to put 300 more workers on the night shift, so that there will be a full crew on this shift. (The contract does not explicitly require that D supply a full second shift, nor does it mention the number of people to be put on the job.)

    Held, for D. The court will not order specific performance where it would be impractical to carry out the order. Granting P the order it seeks would commit the court to "supervising the carrying out of a massive, complex, and unfinished construction contract.…" If D's delays constitute a breach of contract and damage P, P's appropriate remedy is a common-law action for damages brought after the fact. *Northern Delaware Industrial Development Corp. v. E.W. Bliss Co.*, 245 A.2d 431 (Del. Ch. 1968).

    b. **Personal service contracts:** Judicial reluctance to become enmeshed in complex supervision of performance also partly explains courts' unwillingness to order specific performance of ***personal service contracts***. The subject of personal service contracts is discussed further *infra*, p. 315.

C. **Land-sale contracts:** The most common situation in which specific performance is decreed is that in which the defendant breaches a contract under which he is to ***convey*** a particular ***piece of land*** to the plaintiff. Because a particular parcel of land has no exact counterpart elsewhere, money damages will not adequately compensate the plaintiff. Furthermore, a decree of specific performance does not pose difficulties of ***supervision***, since it is easy for the court to verify whether the defendant has made a conveyance, and even to order that the conveyance be recorded without the seller's participation. See Rest. 2d, § 360, Commente.

1. **Buyer has contracted to resell:** Specific performance will be ordered even where the plaintiff buyer has ***already contracted to resell*** the property. In this situation, the courts generally accept the buyer's argument that if he is unable to make the reconveyance, he himself will be liable for damages in an amount which cannot accurately be determined without litigation. *Id.*

2. **Breach by buyer:** Courts are also generally willing to order specific performance of a land-sale contract where the seller has not yet conveyed, and it is the ***buyer who breaches***. In this situation, the courts reason that the value of land is somewhat speculative, and that it will therefore be difficult for the seller to establish the difference between the contract price and the market price. *Id.*

   a. **Seller has already conveyed:** But if the seller has ***already conveyed***, damages will be an adequate remedy if the buyer refuses to pay the purchase price; therefore, specific performance will not be ordered in this situation. *Id.* Instead, the seller must litigate a conventional action to receive the contract amount (plus any consequently damages) as money damages.

D. **Contracts involving personal services:** Equitable relief in connection with ***contracts for personal services*** is subjected to some especially severe limitations.

1. **No specific performance:** Courts will almost ***never*** order ***specific performance*** of a contract for personal services. Rest. 2d, § 367(1). This is true on ***both sides***. That is, the court will not order the employer to resume the employment, nor will it order the employee to perform the services.

   a. **Rationale:** The policy against specific performance of such contracts "is based in part upon the undesirability of compelling the continuance of personal association after disputes have arisen and ***confidence and loyalty are gone****…*" *Id.*, Comment a. Also, in the case of an order against the employee, courts do not wish to impose "what might seem like ***involuntary servitude***." *Id.*

Example 1: *A*, a famous opera star, contracts to sing exclusively in *B*'s London opera house for the coming season. Before the first scheduled performance, *A* repudiates, in order to sing at *C*'s competing London opera house. *B* will not be entitled to a decree of specific performance ordering *A* to perform, even if *B* will suffer great loss which cannot be accurately estimated. Rest. 2d, § 367, Illustr. 1.

Example 2: Same facts as the above example, except that it is *B*, the owner of the opera house, who repudiates the contract before the first performance. Even if *A* will suffer, in addition to lost earnings, a loss of prestige whose dollar value cannot be accurately ascertained, *A* will not be entitled to an order directing *B* to resume the engagement. *Id.*, Illustr. 2.

2. **Injunction:** Because specific performance will almost never be granted in connection with personal service contracts, the rules concerning the availability of ***injunctive*** relief are especially important in this context. Since a promise to render personal services is usually exclusive (i.e., it implies a duty not to render the promised services to anyone else), courts will often enjoin the breaching employee from working for a ***competitor***. Generally, the employer seeking an injunction must overcome three hurdles:

   a. **Unique skills:** The employer must show that the employee's services are ***unique or extraordinary***, either because she has some ***special skill*** or because she has acquired ***special knowledge*** of the ***employer's business***. (The "special skill" criterion is often found to be satisfied in contracts involving ***professional athletes*** or ***entertainment*** stars.) This requirement stems from the requirement that damages not be an adequate remedy; if the employee's services are not "unique or extraordinary," damages will normally adequately protect the employer's interest.

   b. **Other way to make living:** The injunction will not be granted if its likely result will be to leave the employee ***without other reasonable means of making a living***. This requirement will not be satisfied if the ***only alternative*** which would be left open to the employee is to perform the contract. That is, the injunction will not be used as a direct substitute for specific performance.

c. Employer's willingness to perform: Furthermore, even if there are other ways for the employee to make a living, if the ***probable*** result of the injunction will be that the employee performs the contract, "it should appear that the employer is prepared to continue the employment in good faith so that performance will not involve personal relations the enforced continuance of which is undesirable." Rest. 2d, § 367, Comment c.

E. Sale of goods: Traditionally, it has been extremely difficult for a buyer to obtain specific performance of a contract to sell ***goods***. Generally, unless the buyer could show that the goods in question were ***unique***, and could not be obtained elsewhere in the market, he could not obtain an order that the seller deliver them.

1. More liberal UCC rule: But the modern tendency, exemplified by the UCC, is to permit ***much more liberal use*** of specific performance in sales cases. § 2-716(1) makes the general statement that "Specific performance may be decreed where the goods are unique ***or in other proper circumstances.***" § 2-716(1).

a. Uniqueness: If the goods *are* "unique," money damages will probably be inadequate. ***Rare*** objects, and objects of ***sentimental value,*** tend to be "unique," such as a one-of-a-kind ***work of art*** or a ***family heirloom***.

Example: Dealer contracts to sell Collector a painting, Cezanne's "The Card Players," for $10 million. Dealer then gets a higher offer from Tycoon, and contracts to sell the painting to him. Since there is only one "The Card Players," a court will likely conclude that money damages are inadequate, and will grant an order of specific peformance requiring Dealer to convey to Collector.

b. "Other proper circumstances": Even if the goods are *not* "unique," § 2-716(1) recognizes that there may be ***"other proper circumstances"*** for specific performance.

i. **Inability to cover:** Most importantly, the fact that the buyer has ***tried to cover*** and failed will be evidence of such circumstances. Comment 2 to § 2-716(1) states that "***[i]nability to cover*** is ***strong evidence*** of 'other proper circumstances.' " Thus a buyer who is ***unable to procure***

substitute goods within a reasonable time after the breach is likely to be awarded specific performance, even if the seller shows that the goods were not, strictly speaking, "unique."

ii. **Rise in market price not usually sufficient:** On the other hand, if there are other comparable items available in the market, the fact that the ***market price*** of those items (and of the item under contract) has ***risen*** will generally ***not*** by itself be enough to justify specific performance. See, e.g., *Klein v. Pepsico*, 845 F.2d 76 (4th Cir. 1988) (where three similar G-II corporate jets were available on the market, the fact that the price had risen was not enough to justify specific performance, since the price rise could be handled by money damages).

Quiz Yourself on
EQUITABLE REMEDIES

88. Acme An-teeks offers to sell Marge Scavenger the squirting rose boutonniere that George Washington wore to his Inaugural Ball for $5,000, and Marge agrees. Before the transaction takes place, Acme gets another offer for $7,000, which it accepts, thereby breaching the contract with Marge. Marge really wants the boutonniere itself (not just damages), because she's a collector of boutonnieres. Is there any remedy available to her?

89. Sisyphus is a well-known expert on hauling rocks. He enters into an employment contract with the Rocco Rock Hauling Co., in which he agrees to work for three years as Chief Operations Officer. His relationship with Rocco brings great prestige to the company; however, after six months Sisyphus finds the work unbearable and quits.

(A) When Rocco sues Sisyphus for breach of contract, will it be entitled to an order compelling him to come back to work and finish the contract?

(B) Assume for this part only that your answer to (A) is no. What other equitable remedy might be available to Rocco, and on what showing?

(C) Assume for this part that after six months, it's Rocco who's unsatisfied, and Rocco gives Sisyphus the heave-ho. Can Sisyphus obtain an ordering compelling Rocco to reinstate him?

Answers

88. Yes, an order for specific performance (i.e., a court order compelling Acme to honor the original deal with Marge). Where the subject matter of the contract is unique, as here, the court will likely grant specific performance, since damages will not be adequate to compensate Marge for the breach.

89. (A) No. Because of the personal relationship involved and the constitutional prohibition of involuntary servitude, courts will generally deny specific performance as a remedy for breach by an employee of an employment contract.

(B) An injunction against worker for a competitor of Rocco, for the remaining length of the contract. Rocco can receive an order enjoining Sisyphus from working for a competitor for the remaining 2.5 years, if it can prove the following: (1) that Sisyphus has a special skill (which he does, since we know he is an expert on hauling rocks); (2) that Sisyphus will not be left without any other reasonable means of earning a living (the injunction would most likely be limited in geographic scope so that he can get a job *somewhere* in his field); and (3) that if the probable result of the injunction would be that Sisyphus would just decide to come back to work for Rocco, Rocco would be ready, willing and able to take him back.

(C) No. The general rule against orders of specific performance in personal-services (i.e., employment) contracts applies to both employers and employees. Therefore, Sisyphus will not be able to require Rocco to take him back — his only recourse is to sue for damages for the breach.

III. KINDS OF DAMAGE MEASURES

A. Three kinds of interest: Once it is established that a particular plaintiff may recover damages for breach of contract, there remains the often difficult question of how these damages should be calculated. Should the court attempt to put the plaintiff in the position he would have been in had the contract been fully performed? Should it try to put him in the position that he would have been in had the contract never been made? Should it make the defendant give back everything of value that the plaintiff has given him? American contract law recognizes three distinct kinds of interests on the part of a disappointed party which may be worthy of judicial protection:

1. **Expectation interest:** The plaintiff's ***"expectation"*** interest is her interest in having the contract performed. In protecting the expectation interest, the court attempts to ***put the plaintiff in the position she would have been in had the contract been performed***. Usually, this means that the plaintiff recovers the ***profits she would have made*** had the contract been fulfilled.

2. **Reliance interest:** In a particular case, it may be impossible to measure the expectation interest of a plaintiff accurately. In such a situation, the plaintiff may instead recover her ***"reliance" interest***. That is, the court will attempt to ***put the plaintiff in as good a position as she was in before the contract was made***. To do this, the court will normally award the plaintiff his ***out-of-pocket costs*** incurred in the performance he has already rendered.

3. **Restitution interest:** In a few instances, neither expectation nor reliance damages will be appropriate. If so, the court may protect what is called the plaintiff's ***"restitution interest."*** That is, the court will force the defendant to pay the plaintiff an amount equal to the ***benefit which the defendant has received*** from the plaintiff's performance.

   We consider each of these interests in turn in its own major section. (For reliance, see p. 326; for restitution, see p. 330.)

IV. EXPECTATION DAMAGES

A. Expectation interest: Expectation damages are the usual, and in some situations the only, measure of damages for breach of contract. In awarding expectation damages, the court attempts to ***put the plaintiff in the position she would have been in had the contract been performed by the defendant***. Normally, this means that the plaintiff is awarded the ***profit*** which she would have made had the contract been performed.

Example 1: On March 1, D, the owner of Blackacre, contracts to sell it to P on July 1 for $500,000. Real estate prices rise, and D reneges. On July 1, D sells the property for $700,000 (which is the highest price any likely buyer would have paid). P will be permitted to recover $200,000 from D, the difference between the contract price and the market price at the time of breach, since that amount will put P in the position he would have been in (making a $200,000 profit) had the contract been performed.

Example 2: Plaintiff's hand is scarred from a severe burn. Plaintiff contracts with defendant surgeon for a skin graft operation which, the defendant promises, will make plaintiff's hand completely normal. Not only does the operation fail to correct the scar, but it also causes plaintiff's hand to become covered with hair.

Held, plaintiff may recover the difference between the value of a perfect hand and the value of the scarred and hairy hand. That is, plaintiff is awarded expectation damages, i.e., the difference between what he would have received had the contract been performed (a perfect hand) and the position he was left in after defendant's breach (a scarred and hairy hand). *Hawkins v. McGee*, 84 N.H. 114 (1929).

Note: Observe that the award of expectation damages in *Hawkins* produced quite a different result from that which would have been produced had reliance damages been awarded. Plaintiff's reliance damages would have been the difference between the value of the scarred (but not hairy) hand and the value of the scarred and hairy hand. That is, by reliance damages, plaintiff would have been restored to the position he was in before the contract was agreed upon.

1. **"Benefit of the bargain":** The idea behind expectation damages is often described as giving the plaintiff the ***"benefit of her bargain."***

B. Usual formula for calculating expectation damages: A plaintiff's expectation damages can be expressed by this formula:

> [1] *the amount by which the value of the defendant's* ***actual performance*** *was less than the* ***value of the promised performance***
>
> minus
>
> [2] *whatever* ***benefits****, if any, the plaintiff received from* ***not having to complete his own performance****.*

Generally, the benefits in [2] are ***expenditures*** which the plaintiff would have had to make to complete his performance under the contract, but which he didn't have to make because the defendant breached first. See Rest. 2d, § 347.

Example of formula: Contractor contracts to build a house for Owner for

$300,000. The contract provides that after Contractor has done half the work, he is to receive $150,000. Contractor does half the work, and demands payment. Owner refuses, and announces that he does not wish Contractor to continue the building. At this point, it would cost Contractor (taking into account materials, but also payments to Contractor's employees) $100,000 to complete the house, a sum which Contractor has saved by virtue of Owner's breach. Contractor's expectation damages are equal to: (1) the difference between the value of Owner's promised performance ($300,000) and the value of Owner's actual performance ($0); minus (2) the benefit to Contractor of not having to complete ($100,000), or $200,000.

C. Construction contracts: Many problems involving the computation of damages involve ***construction contracts***, so we'll look at these in some detail. We'll call the person doing the construction the "builder," and the person receiving the benefit of the work the "owner."

1. Builder breaches: First, let's look at how the owner's damages are computed if the ***builder breaches***, and the owner has the work completed by a second builder. A good formula for computing the owner's damages is:

> [1] The value the building ***would have had*** if it had been completed as agreed upon ...
>
> [2] Less the value of the building ***as completed*** by the second builder ...
>
> [3] Plus the amount by which (a) the ***totals paid*** by the owner to the first and second builders together ***exceed (b) the contract price***...
>
> [4] Plus any consequential damages from the ***delay***.

Farnsworth §12.11 at 775-776.

Example: Builder 1 contracts to build a house on Owner's land for $500,000. Builder 1 does the initial work defectively, then abandons the job in the middle of construction. At the time of abandonment, Owner has paid Builder 1 $200,000. If the house had been completed as contracted for, it would have been worth $600,000 (i.e., Owner made a favorable contract). Owner hires Builder 2 to complete the job for $400,000. Because the defective work done by Builder 1 before abandonment can't be readily remedied, the house as completed is worth only $550,000. Due to the delays caused by the breach, Owner loses $50,000 in rental income.

Owner can recover from Builder 1:

(1) $600,000 (value if completed as per the original contract) ....

(2) Less $550,000 (value as actually completed, due to Builder 1's poor work) ...

(3) Plus the difference between $600,000 (the sum of the $200,000 Owner paid to Builder 1 and the $400,000 he paid to Builder 2) and $500,000 (the contract price), or $100,000 ...

(4) Plus $50,000 lost rental as delay damages.

So Owner recovers:

$600,000 - $550,000 + 100,000 + $50,000, or

$200,000

2. Owner breaches: Now, let's look at how the ***builder's*** damages are computed if the ***owner breaches*** when the work has ***not yet been completed.***[1] A good formula for computing the builder's damages (using somewhat different components than the usual expectation formula on p. 319) is:

[1] The money the builder has ***spent so far*** in fulfilling the contract (the builder's "***reliance***" cost; see *infra*, p. 326, for more about reliance) ...

[2] Less any ***salvage value*** to the builder from the partial performance, such as materials purchased that can be used on another project ("***loss avoided***") ...

[3] Plus the ***profit*** the builder ***would have made*** had the contract been completed ...

[4] Less any ***progress payments*** already made by the owner.

Farnsworth §12.10 at 770.

Example: Builder contracts to build a house on Owner's land for $500,000. At a time when Owner has paid Builder $60,000 and Builder has spent $200,000, Owner repudiates. Builder cancels and sues. The $200,000 spent by Builder includes $20,000 of lumber that he can use on another job. If the contract had been completed, Builder would have made a profit of $100,000. Builder can recover:

(1) The $200,000 he has spent in “reliance”;

(2) Less the $20,000 he can get for the lumber (“loss avoided”);

(3) Plus the $100,000 profit he would have made had the project been completed on both sides;

(4) Less the $60,000 already paid by Owner.

So Builder recovers:

$200,000 - $20,000 + 100,000 - $60,000, or

$220,000

D. Allocation of overhead: Where the plaintiff has not finished his performance at the time of the defendant’s breach, should the plaintiff’s cost of completion (the amount he has saved by not having to finish) include a portion of his ***overhead***? The answer given by most courts is “no” — since overhead is by definition fixed, there is no saving of any of it as a result of P’s not having to finish the contract; this conclusion is to the plaintiff’s advantage, of course. See, e.g., *Vitex Manufacturing Corp. v. Caribtex Corp.*, 377 F.2d 795 (3d Cir. 1967).

E. Cost of completion vs. decrease in value: The general principle in awarding expectation damages is, as we have seen, that the plaintiff should be put in the same position he would have been in had the contract been performed. This formula leads to difficulty, however, in those situations where the difference between the economic value of a complete performance under the contract and the value of the defendant’s defective performance is ***less than the cost of remedying*** defendant’s defective performance. In such a case, should the plaintiff be awarded the net economic loss he has sustained by virtue of the defendant’s breach (the lesser sum) or the cost of remedying defendant’s defective performance (the greater sum)? The problem is illustrated by the following example.

> **Example:** Plaintiffs own a farm containing coal deposits. They lease the premises to Defendant for a five-year term, for the purpose of allowing Defendant to strip-mine on the property. Because of the unsightliness of a strip-mining operation, Plaintiffs insist that the lease contain a clause requiring Defendant to perform various work to restore the beauty of the property at the end of the lease term. Plaintiffs are unwilling to sign the lease without these terms, and they are included. At the end of the lease, Defendant fails to perform this restoration work. Evidence

shows that it would cost Defendant about $29,000 to perform the work, because of the great quantities of dirt which would have to be moved. However, the value of the farm is only about $300 less than it would have been had Defendants performed this work. In fact, the total value of the farm is less than $5,000. In the Plaintiff's suit for damages for breach, should they be awarded $300 or $29,000?

Held, only the diminution in value, $300, should be awarded. This is true for two reasons: (1) the provision of the contract requiring the remedial work is only incidental to the main purpose of the contract; (2) the economic benefit which the Plaintiffs would receive from full performance of the work is grossly disproportionate to the cost of performing the work. Thus ***"economic waste"*** would be involved. *Peevyhouse v. Garland Coal & Mining Co.*, 382 P.2d 109 (Okla. 1962).

1. **"Clearly disproportionate" standard:** Most modern courts would probably agree with the *Peevyhouse* court's approach. The Second Restatement provides that the court should not grant the cost of remedying defects "if the cost is … ***clearly disproportionate*** to the probable loss in value" to the plaintiff. Rest. 2d, § 348(2)(b). Since an expenditure of $29,000 is clearly disproportionate to the $300 by which P's property would have increased in value, the Restatement test would produce the same result as the court reached in *Peevyhouse*. (But under the Restatement approach, an expenditure of $30,000 to fix a defect which, if fixed, will increase the value of the property by $20,000, is ***not*** clearly disproportionate, so the $30,000 may be awarded. See Rest. 2d, § 348, Illustr. 3.)

2. **Economic waste:** A court is particularly unlikely to award the cost of completion where the defect is minor, and its completion would involve what is sometimes called ***"economic waste."***

   a. **Destruction of work already done:** Thus the court will often rely on economic waste to decline to award cost-of-completion where the situation involves a ***building contract*** and remedying the defect would require the ***destruction of what has already been done***. *Peevyhouse* is an illustration. Another is given in the following example.

Example: Contractor contracts to build a house for Owner. The contract specifies that Reading pipe must be used. Contractor inadvertently substitutes Cohoes pipe, which is of virtually the same quality as the Reading. Owner objects, and refuses to pay the remaining contract amount. In a suit by Contractor for the remaining contract amount, should Owner be entitled to subtract from the contract price the full cost of changing the pipe (a large sum, since all of the existing plumbing would have to be torn out), or merely the amount by which the house is diminished in value because of the substitution of pipe (a negligible sum)?

Held: (1) Contractor may recover on the contract, since he substantially performed (see *infra*, p. 333). (2) The correct measure of damages is "not the cost of replacement, which would be great, but the difference in value, which would be either nominal or nothing." To hold otherwise would cause Contractor to suffer a forfeiture, without any correspondingly great benefit to Owner; the cost of completion is "grossly and unfairly out of proportion to the good to be attained." *Jacob & Youngs v. Kent*, 230 N.Y. 239 (1921). See also Rest. 2d, § 348, Illustr. 4 (based on *Jacob & Youngs).*

A dissent contended that this was not a case in which there was an "unsubstantial omission." Owner "contracted for pipes made by the Reading Manufacturing Company. What his reason was for requiring this kind of pipe is of no importance. He wanted that and was entitled to it.…"

b. Economic analysis: The situation of "waste" is a good example of how ***economic analysis*** (see *supra*, p. 2) can help explain some of the principles of contract law. Requiring the Contractor in *Jacob & Youngs v. Kent* to tear out the existing plumbing (or to pay for someone else to do it) is clearly economically inefficient, since the total "market value" of the remedy is far less than the cost of that remedy. Proponents of the law-and-economic school therefore typically approve of the result in a case like *Jacob & Youngs.*

i. **Right to get what one bargained for:** But critics of the law-and-economics school point out that the "waste" analysis deprives Owner of the ability to ***get what he bargained for.*** As one such critic has written, "It is simply right that one get what he was promised." 81 Colum. L. Rev. 111, 138, quoted in K&C, p. 1016. Furthermore, the law-and-economics approach often encourages promisors to ***behave unethically***, especially since transaction costs (e.g., legal fees) will usually discourage the victim from suing.

c. Willfulness: Perhaps out of fear of inducing breach, an important factor that tends to lead the court to award cost-of-completion, rather than diminution-in-value, is that the defendant's breach was ***"willful"*** and also intentional, in the sense that he knew all along that he was not complying with the contract. For instance, had the contractor in *Jacob & Youngs* known that he was substituting one pipe for another, and done so to save money, the court is far less likely to have docked him only for the lessening of value.

d. **Non-construction contracts:** Practically all the cases where the cost-of-completion method rather than the diminution-in-value method is used involve ***construction*** contracts. Outside of the construction context, use of the cost-of-completion method will probably produce illogical results, since there is likely to be confusion about what the "thing" is that the plaintiff is entitled to complete.

F. **Requirement of reasonable certainty:** The plaintiff may only recover for losses which he establishes with ***"reasonable certainty."*** Rest. 2d, § 352. That is, the plaintiff must not only show that he has had losses, but must also show the ***amount*** of these losses with reasonable certainty. The main application of this rule is that a plaintiff who claims that he would have ***made profits*** had the defendant not breached must show not only that there would have been profits, but also the likely amount of those profits.

1. **Profits from a new business:** Where the plaintiff claims profits from a business or venture which at the time of breach was ***not yet in actual operation***, the courts are reluctant to award such lost profits, due to their speculative nature.

a. **Old business used for estimation:** However, modern courts may be willing to allow recovery of prospective profits from a new venture if the plaintiff can show that he ran a ***previous operation*** of a similar nature, or had experience in that particular industry.

Example: D breaches a contract to rent certain retail space to the Ps for a "book and bottle" shop (i.e., a combination liquor and book store).

Held, the Ps may recover the profits that would have been made. Profits from a new business are often not recoverable, but that this is only because such profits are usually uncertain. Given that the Ps had prior experience in both the book and liquor store industries, and presented detailed testimony concerning the profits typically made in these industries, there was enough evidence from which the jury could award lost profits. *Fera v. Village Plaza, Inc.*, 242 N.W.2d 372 (Mich. 1976).

b. **Doubts resolved against defendant:** Another limitation on the principle that the plaintiff must show lost profits with reasonable certainty is that where the defendant's breach is the very thing that makes it difficult for the plaintiff to establish lost profits with certainty, the court will try to resolve the matter in a way that

punishes the defendant, not the plaintiff, for the resulting uncertainty.

Example: P owns the hardcover publishing rights to the novel "Hunt for Red October." P licenses to D the rights to publish a paperback edition of the book, with D agreeing not to ship the paperback to stores earlier than October 1985. D jumps the gun, and makes shipments in September. P asserts that this breach has caused it to sell fewer hardcover books in September than P would otherwise have sold. However, P is unable to show precisely how many copies it would have sold in September absent the breach. The trial judge therefore assumes that P's sales for September would have been the same as those for August (even though sales were apparently trending downwards even before the breach).

Held (on appeal), the trial judge did not commit error: "Though the [trial] court accurately described its selection of August 1985 sales as its benchmark as 'generous[],' it was not improper, given the inherent uncertainty, to exercise generosity in favor of the injured party rather than in favor of the breaching party." *U.S. Naval Institute v. Charter Communications, Inc.*, 936 F.2d 692 (2d Cir. 1991).

2. **Public whim:** Courts are especially unlikely to find that lost profits have been demonstrated with the requisite certainty where the venture is of a sort that ***depends on the public whim***. Farnsworth, p. 832-33. This is true, for instance, of many ***entertainment and sporting events*** (e.g., a contract to stage a boxing match.)

   a. **Evidence of comparable enterprises:** Again, however, modern courts are more willing to allow evidence of profits made from closely comparable ventures. For instance, a modern court might well accept evidence of the profits earned by other title fights by the same champion, and perhaps even other fights of comparable stature put on by the same promoter. See Farnsworth, pp. 833-34.

3. **Cost of completion unknown:** Expectation damages may be too uncertain to be awarded even where the only duty breached by the defendant was a duty to pay a price for the plaintiff's performance. This situation is illustrated most frequently by the case of a plaintiff contractor, who sues for lost profits on a job that was terminated before its completion by the defendant owner's breach. Unless the contractor in this situation can show with some specificity what it would have ***cost him to complete the job,*** he will not be able to recover his expectation damages.

Example: Contractor contracts to build a house for Owner for $30,000. After he has done roughly half the work, and expended $10,000, Owner repudiates the contract. Contractor's normal expectation measure of damages would be the contract price less his cost of completion. But if Contractor cannot demonstrate this cost of completion with adequate specificity, he will be unable to recover expectation damages at all. He may, however, be able to recover either reliance or restitution damages, as discussed below.

4. **Alternative damage measure chosen:** If lost profits are found to be too speculative, the courts will frequently adopt some alternative measure of damages. In many instances, this alternative measure will be the plaintiff's ***reliance*** damages (discussed in the next section). In cases involving equipment and farm land, the courts have often used the property's ***rental value*** as a substitute for the profits that could have been made from it.

5. **UCC has liberal certainty requirement:** The UCC takes a somewhat liberal view of the requirement that damages be proved with appropriate certainty. Comment 4 to § 2-715 (allowing the buyer to recover "consequential" damages) states that "the burden of proving the extent of loss incurred by way of consequential damages is on the buyer, but the section on liberal administration of remedies [§ 1-305] ***rejects*** any doctrine of certainty which requires ***almost mathematical precision*** in the proof of loss. Loss may be determined ***in any manner which is reasonable*** under the circumstances." **??**

G. UCC follows expectation rule: As a general rule, the UCC awards both an aggrieved buyer and an aggrieved seller expectation damages. UCC § 1-305(a) provides that all Code remedies "shall be liberally administered to the end that the aggrieved party may be ***put in as good a position as if the other party had fully performed***." However, the Code sets forth a number of specific rules for calculating damages both in the breaching-buyer and breaching-seller situations. These rules are discussed extensively in a special section devoted to UCC damages, *infra*, p. 364.

Quiz Yourself on
EXPECTATION DAMAGES

90. Drew Idd hires the Landmark Construction Co. to build the Stonehenge Resort on Idd's property. The contract price is $500,000. When the frame is complete, Idd commands Landmark to stop work, and he refuses to pay for the building. Up to that point, Landmark has spent

$100,000, and would have needed to spend another $200,000 to complete the job. Idd paid $250,000 up front.

(A) How much will Landmark be able to recover if it sues on the contract?

(B) Assume that Landmark is unable to determine what its cost of completion would have been. Can it still recover its expectation damages?

91. Bo Peep decides to get out of the sheep business and open up a business selling household cleaners door-to-door. She enters into a contract with Mr. Clean in which he agrees to supply her with household cleaners at wholesale cost for the next 12 months. Before Bo Peep gets her first shipment, Mr. Clean breaches the agreement. Bo Peep figures that with her pretty face and smooth-talking style, she could have made $1,000 a month in profits from her new venture.

(A) When Bo sues for breach, can she recover the $1,000/mo. she believes she would have made, for the 12 months covered by the contract?

(B) Now assume that Bo Peep had been in her new business for three years before she entered into her agreement with Mr. Clean, during which she had purchased comparable supplies at similar pricing from a different supplier. She can show that she made a profit of $1,000/mo. in the last year of that arrangement, and that she cancelled that arrangement to make the new one with Mr. Clean. She can further show that when Mr. Clean cancelled, any other then-available arrangement would have been so much more expensive (due to changing industry conditions) that she would have made no profit. May Bo recover the $1,000/mo. she believes she would have made from the contract with Mr. Clean, for the 12 months covered by the contract?

Answers

90. (A) $50,000 — that is, the balance of the contract price ($250,000) less Landmark's remaining cost to complete ($200,000).

(B) No. If a contractor cannot show with some specificity what it would have cost him to complete the job, he will not be able to recover his expectation damages. Under these facts, Landmark will likely only be able to recover the value of the benefit it has conferred upon Idd (restitution damages).

91. **(A) No.** A plaintiff can only recover damages that she can prove with reasonable certainty. Lost profits on a brand new business venture are normally too speculative.

(B) Yes. The fact that Bo has previously made $1,000/mo. under a similar arrangement means that there is a "reasonable certainty" that she would have made this amount in the new venture. Therefore, unless Mr. Clean can show some reason why past conditions would not have applied to the new contract, Bo will be able to recover, as expectation damages, $1,000 x 12 months, or $12,000.

V. RELIANCE DAMAGES

A. General function of reliance damages: In most contract situations, the award of expectation damages will adequately compensate the plaintiff. But in some contract situations, and several non-contractual situations, expectation damages are not suitable, and ***reliance*** damages may therefore be appropriate. These situations include those in which:

- ☐ plaintiff cannot show his ***lost profits with sufficient certainty***, but can nonetheless show items of expenditure;
- ☐ plaintiff is a ***vendee under a land contract*** who sues the vendor for the latter's refusal to convey the property to him, and the jurisdiction is one in which expectation damages are not awardable in this situation; and
- ☐ there is ***no legally enforceable contract*** but the plaintiff is entitled to some protection (a situation typified by cases invoking the doctrine of ***promissory estoppel***).

1. Reliance damages as a component of expectation damages: Before we look at the situations in which reliance is the total measure of damages, note that reliance damages are also a built-in ***component*** of the usual ***expectation*** damages award. Normally, reliance damages are hidden within the usual expectation formula: contract price minus cost of completion. Other formulas for calculating the expectation interest, however, make the reliance component more evident. Sometimes, for example, a plaintiff will calculate his expectation interest by the following formula:

[1] *cost to P of work already performed +*
[2] *the total profit P would have made on the contract,* where "total profit" is defined as:
[3] *contract price – P's total cost of performing.*

The "cost to P of work already performed" is, of course, essentially a reliance measure.

Example: P, a roofer, contracts to place 500 square feet of roofing on O's house. He is to be paid $4 per square foot. After he has put up 100 square feet, O repudiates the contract. At trial, P proves that: (1) he expended $300 for materials and wages for the work already done; (2) $4 per square foot is his standard price for roofing, and this was a standard job; and (3) from long experience with this kind of standard job, P knows that his profit is 25% of the contract price.

Based on this proof, P will probably be entitled to recover the $300 already expended, plus the anticipated profit on the whole job (25% of the overall contract price, or $500). In other words, P's $800 total expectation interest award can be viewed as being composed of a reliance component (the $300 expended) and a net profit component (the $500).

B. Reliance damages where profits too speculative: As we have seen (*supra*, p. 323), lost profits may not be awarded where they are too ***speculative*** or ***uncertain***. Where proof of lost profits fails for uncertainty, the court may award the plaintiff compensation for expenditures he made in ***preparing to perform the contract***, and those he made in ***actually making part performance***. Reimbursement for these out-of-pocket expenditures thus protects the plaintiff's reliance interest. The "speculative lost profits" situation is the principal kind of suit ***on the contract*** in which reliance damages are awarded. See Rest. 2d, § 349, Comment a.

C. Promissory estoppel: Where the plaintiff brings an action based on ***promissory estoppel*** (*supra*, p. 136), the courts often refuse to grant the plaintiff the profits he would have made had the promise been kept, but instead grant the plaintiff his reliance damages. In so doing, the courts use reliance damages as a means of "avoiding injustice," the goal of promissory estoppel. That is, the court reasons that although the plaintiff should not be entirely barred from recovery, he should not have the full benefits of the usual contractual measure of recovery, since there was no traditionally-enforceable contract.

> **Example:** Plaintiff applies to Defendant, a radio distributor, for a franchise to sell Emerson radios. Defendant erroneously tells Plaintiff that the franchise has been approved, that Plaintiff can proceed to employ salespeople and solicit orders, and that an initial shipment of thirty radios will be made. Plaintiff spends $1,150 in making preparations to do business, but does not receive either the franchise or the radios. Since no legally enforceable contract was ever formed, Plaintiff brings a suit based on promissory estoppel.
>
> *Held*, plaintiff may not recover the profits he would have made had the thirty radios been received and sold. However, he may recover reliance damages, i.e., his expenditures in preparing to do business (the hiring of salesmen and the solicitation of orders). *Goodman v. Dicker*, 169 F.2d 684 (D.C. Cir. 1948).

D. Doctor-patient contracts: A few courts have awarded reliance damages in suits brought by ***medical patients*** against doctors (usually surgeons), where the plaintiff shows that the doctor affirmatively ***promised to achieve a particular result.*** (*Hawkins v. McGee*, *supra*, p. 319, was such a contract case, though expectation damages rather than reliance damages were awarded.)

> **Example:** D, a plastic surgeon, promises P, a professional entertainer, that two operations which D will perform on P's nose will improve her appearance. D performs the two operations, but P's condition is worsened; a third operation fails to restore it to its original state. There is no evidence that D acted negligently. P sues on the contract.
>
> *Held*, P may recover reliance damages. Restitution damages (see *infra*, p. 330) would be too meager a recovery, since these would be limited to the fee paid to D. Yet expectation damages (the difference between the value of the nose as it was before the operation and the value of the nose as D promised to make it) might be excessive, and would frighten doctors into practicing "defensive medicine." Therefore, reliance damages are an appropriate measure.
>
> Consequently, P is entitled to: (1) the amount of the fee which she paid to D; (2) the difference in value between her nose as it was before the operation and her nose as it was thereafter; and (3) her pain and suffering and mental distress to the extent that these exceeded what would have been involved in a successful performance by D (i.e., at least the pain and suffering and mental distress involved in the third operation, attempted solely for restorative purposes). The court declines to determine whether the pain and suffering that would have been involved even in a successful operation may be recovered under the reliance theory (though such recovery is arguably required, since the suffering has been "wasted"). *Sullivan v. O'Connor*, 296 N.E.2d 183 (Mass. 1973).

E. **Limitations on amount of reliance recovery:** The plaintiff's reliance damages are sometimes ***limited*** to a sum ***smaller than his actual expenditures***.

1. **Contract price as limit:** Where the defendant's only obligation under the contract is to pay a sum of money (the contract price), reliance damages will almost always be ***limited to this contract price***. The reason for this is that courts do not want to give the plaintiff a windfall in the form of reliance damages greater than his expectation damages would have been, and expectation damages will seldom be greater than the contract price.

2. **Recovery limited to profits:** As just stated, the plaintiff will almost never be allowed to recover reliance damages in excess of the contract price. A more difficult question, however, is whether the plaintiff's reliance damages are also limited to the contract price ***minus*** the cost of completion, where the plaintiff has not completed his performance. That is, ***may the plaintiff's reliance damages exceed his expectation damages***? (Expenditures can exceed expectation damages only if the contract would have, if completed, resulted in a ***loss*** for the plaintiff.) Most courts ***refuse to allow reliance damages to exceed expectation damages***, but place the ***burden of proof on the defendant*** to show what the plaintiff's loss would have been. This is the approach of the Second Restatement; see Rest. 2d, § 349.

   a. **Where no evidence of cost of completion:** If the defendant's breach has prevented the plaintiff from completing his performance, and neither the plaintiff nor the defendant brings forward satisfactory evidence of how much it would have cost plaintiff to complete the contract (and thus it is uncertain what plaintiff's net profit would have been), the plaintiff may normally ***recover his entire reliance damages***, limited only by the contract price. Thus the plaintiff is not required to rebut the defendant's allegation that the plaintiff would have lost money on the contract, unless the defendant comes forth with actual satisfactory evidence of this allegation.

   b. **Where defendant proves that plaintiff would have lost money:** If, on the other hand, the defendant is able to ***prove*** that the plaintiff

would have suffered a net loss on the contract had it been completed, the plaintiff's reliance recovery will be ***limited to what his expectation damages would have been on completion.***

Example: P enters into a contract with D to build a bridge for $150,000. After P is part way through the construction, D repudiates the contract and does not pay P anything. P has spent $100,000 in reliance expenditures. D proves at trial that P would have needed to spend an additional $110,000 to complete the project, resulting in an overall $60,000 loss for P had the contract been performed.

There will be subtracted from P's reliance damages the amount of the loss which D shows that P would have suffered had the contract been performed. So P's recovery would be computed as follows: $100,000 in reliance damages less $60,000 loss to him if there had been completion, or a net recovery of $40,000.

3. **Expenditures prior to signing of contract:** The plaintiff will normally not be permitted to recover as reliance damages expenditures made ***before the contract was signed***, since these expenditures cannot be said to have been made "in reliance on" the contract.

F. Cost to plaintiff, not value to defendant: When reliance damages are awarded, they are usually calculated according to the ***cost to the plaintiff*** of his performance, ***not*** the ***value to the defendant.*** Thus even if the plaintiff's expenditures were all incurred in preliminary preparations to perform, and the defendant breached before plaintiff even began actual performance, plaintiff will be able to recover his cost of preparation. (In the case of *restitution* damages, discussed below, this will not always be the case; in restitution, the benefit to the defendant, not the cost to the plaintiff, is the usual measure.)

G. Reliance damages under the UCC: The UCC does not explicitly deal with the issue of reliance damages. However, it is clear that in cases brought on the contract, where the plaintiff cannot show lost profits with sufficient certainty he may recover his reasonable expenditures made in connection with the contract.

1. **Incidental damages:** This is most clearly indicated by UCC § 2-715(1), which allows an aggrieved buyer to recover ***"incidental damages,"*** defined to include "expenses reasonably incurred in inspection, receipt, transportation and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with effecting cover and ***any other***

reasonable expense incident to the delay or other breach." ??

VI. RESTITUTION

A. Restitution generally: Just as a court may award the plaintiff her expectation interest (her expenditures plus the profit she would have made on the contract) or her reliance interest (her expenditures), so the court may decide to protect the plaintiff's ***restitution interest***. The plaintiff's restitution interest is defined as the ***value to the defendant of the plaintiff's performance***. Restitution damages may be awarded to the plaintiff both in a suit on the contract (discussed here) and in a suit brought in quasi-contract (discussed on p. 335). The goal of restitution is the ***prevention of unjust enrichment***.

1. Calculation of value: The distinguishing quality of the restitution interest is that it is ***value rendered to the defendant***, regardless of how much the conferring of that value cost the plaintiff, and regardless of how much the plaintiff was injured by the defendant's breach. If the performance has no value to the defendant, there can be no restitution damages, regardless of how much it may have cost the plaintiff to perform.

a. Market value is the standard: However, although it is the value to the defendant that is determinative, this value is usually the sum which the defendant would ***have to pay to acquire the plaintiff's performance***, ***not*** the ***subjective value*** to the defendant, nor the amount for which the defendant could ***resell*** the plaintiff's performance. Rest. 2d, § 371(a).

Example: Contractor contracts to build a grotesque outhouse on Owner's property. After Contractor has completed three-fourths of the work, Owner repudiates the contract. At trial, Contractor shows that he spent $15,000 out-of-pocket to do the three-quarters of the job which he did. Owner shows that contractor was highly inefficient, and that he (Owner) could have hired X to do the three-quarters of the work actually done for $10,000. Owner also shows that the three-quarters of an outhouse actually diminished the value of his property, and that even if the outhouse were completed, the value of the property would still be less than before the contract.

In this situation, Contractor's restitution interest would probably be held to be $10,000, the amount which it would cost Owner to duplicate Contractor's work on the open market. The amount expended by Contractor in performing (i.e., his reliance damages) is irrelevant to this calculation; the diminution in value of Owner's property would also probably be irrelevant. See Murray, p. 482.

B. Restitution as a remedy for breach of contract: When a party is in the process of performing a contract, and the other party commits a material breach of the contract, the aggrieved party has the right to ***rescind the contract***, and recover restitutionary damages for the breach. Even though this rescission purports to dissolve the contract, plaintiff's suit is really on the contract (not in quasi-contract), and restitution damages are merely one option available to him, as are expectation and reliance damages.

1. Where expectation damages can't be estimated: The most common situation in which restitution damages are awarded in on-the-contract actions is where the plaintiff's expectation damages ***cannot be estimated with sufficient certainty.***

> **Example:** Where a construction contractor does part of the work, and the owner breaches, the contractor may be unable to show what his cost of completion would have been. In that event, the contractor will normally be permitted to recover restitution damages, calculated as the market value of the partially-completed performance.

C. Restitution not limited to the contract price: The most significant utility of the restitution measure of recovery is that, according to most courts, ***it is not limited by the contract price***. If the work done by the plaintiff prior to the defendant's breach has already enriched defendant in an amount greater than the contract price, this entire enrichment may be recovered by the plaintiff. The restitution measure is thus completely different from the reliance measure, which, as we have seen (*supra*, p. 328), is normally limited to the contract price.

1. Rationale: One rationale for allowing a plaintiff's restitution recovery to exceed the contract price (i.e., to allow restitution to exceed expectation damages) has been expressed as follows: "to permit [the defendant] to use his breached contract to limit a recovery against him would be to ***pay him a premium for his own wrong***." *Johnston v. Star Bucket Pump Co.*, 274 Mo. 414 (1918).

a. Other reasons: Also, where the contract price is expressed as a unit price (e.g., $23 per cubic foot excavated), the plaintiff may have named a lower unit price for a large volume of work than he would have had the work been limited to the amount he actually ended up performing. See F&Y, p. 504, Note 2. Furthermore, there may have been other anticipated benefits, external to the contract, which the plaintiff contemplated receiving and which he has lost through not being able to finish. For instance, a contractor might be eager to perform the entire job, so that he can show it to prospective customers as an example of his work.

2. **Restitution not available where plaintiff has fully performed:** If at the time of the defendant's breach, the plaintiff has ***fully*** performed the contract (and the defendant owes only money, not some other kind of performance), most courts do ***not allow the plaintiff to recover restitutionary damages***. The plaintiff is then relegated to his expectation measure (usually the contract price, since by hypothesis there is no remaining cost of completion). Rest. 2d, § 373(2).

   a. **Anomalous result:** Limiting the fully-performing plaintiff to the contract price, but not so limiting the partly-performing plaintiff, can produce the anomalous result that the plaintiff is ***penalized for finishing off his performance.***

D. **Restitution in losing contract:** Not only may the restitution award exceed what the plaintiff's expectation damages would have been, full restitution may even be awarded where the plaintiff has partly performed, and ***would have lost money*** had the contract been completed. Rest. 2d, § 373, Comment d; Farnsworth, p. 856-57.

> **Example:** P contracts to perform sub-contract work for D, a general contractor. After only part of the work has been done, D unjustifiably fails to make certain payments, and P terminates work. At this time, P is already owed $37,000. D shows that had P completed the contract, P would have had an overall loss of more than $37,000; D thus argues that it should not owe any money (since P is already in a better position than it would have been in had it finished the contract).
>
> *Held*, for P. Even though the normal expectation measure of damages will produce no recovery for P, P is entitled to recover in *quantum meruit*. P's measure of recovery will be "the ***reasonable value*** of [its] performance," i.e., "the amount for which such services ***could have been purchased*** from one in [P's] position at the time and place the services were rendered." The contract price may be evidence of this amount, but will not be dispositive on the question. Remanded for further calculation of the correct damage amount. *U.S. v. Algernon Blair, Inc.*, 479 F.2d 638 (4th Cir. 1973).

E. **Restitution for the breaching plaintiff:** The cases discussed so far in this chapter have involved plaintiffs who, at the time of the defendant's breach, were not themselves materially in default. If the plaintiff materially breaches the contract, he may be entitled to recover the amount by which the defendant has been enriched (whether or not the defendant was also in breach). However, the defaulting plaintiff's suit must be brought in quasi-contract, not on the contract. Discussion of the rights of the breaching plaintiff is therefore treated in the material on quasi-contract, *infra*, p. 337.

Quiz Yourself on
RELIANCE AND RESTITUTION DAMAGES

92. Maria von Trapp has never been in business before. She enters into a contract with Yoddle-Ey-Hee-Hoo, a chain of Bavarian clothing stores, to open a franchise. In anticipation of her store's opening, she spends $150 on printing for price tags, puts a $2,000 nonrefundable deposit down on a space for the store, and purchases $500 worth of mannequins. Yoddle-Ey-Hee-Hoo then pulls the rug out. Maria sues for breach. She estimates that her lost profits would have been $2,000 per month for the first year. None of the purchased items have any salvage value. Assuming that Yoddle is found to have breached, what are Maria's damages, and on what theory?

93. Neulla Rich enters into a contract with the Rococo House of Design to redecorate her New York penthouse. Rococo designers set to work immediately. They install new wallpaper and lighting in Neulla's house, and paint a mural of little cherubs on her dining room ceiling. Shortly thereafter, Neulla breaches the agreement by refusing to pay for anything. Rococo has spent $10,000 (including labor) on the installation of the wallpaper, lighting and mural, and the market value of these items is $15,000. The total redecorating contract was for $50,000.

(A) Assume that Rococo cannot estimate with specificity what its cost of completion would have been. If Rococo sues, what damages can it collect?

(B) Now assume that the total contract price was $12,000. How much may Rococo recover?

(C) Now assume that Rococo has fully performed under the contract, and Neulla has refused to pay anything. Rococo spent $25,000 to perform. The market value of the new décor (what a reasonable home owner would expect to pay for it) is $60,000. The total contract price was $50,000. What damages can Rococo recover?

Answers

92. **$2,650, on a reliance damages theory.** Maria will not be entitled to collect lost profits because she will be unable prove them with any certainty, since this is a new venture for her and she has never operated a comparable venture. However, Maria will be entitled to be reimbursed for the expenditures she made in preparing to perform under the contract. Her reliance damages will be $2,650, or the total of all she reasonably shelled out (and cannot salvage) in anticipation of the store's opening.

93. **(A) $15,000.** Where, as here, a party can't estimate her expectation damages with sufficient certainty, the party may recover restitution damages. Therefore, Rococo can collect restitution damages to compensate it for the benefit it has conferred upon Neulla. These damages will be $15,000, or the market value of the work it has done.

    (B) $15,000. With restitution damages, a party who has not yet fully performed can collect an amount *in excess of* the total contract price. (Yes, this is paradoxical, but the law is pretty clear on this point.) So Rococo will be entitled to its $15,000 even though the contract price was only $12,000.

    (C) $50,000. Ironically (in light of the answer to (B)), when a party has ***fully performed*** under a contract and the other party's breach amounts to a failure to pay money, most courts will ***limit*** the plaintiff's recovery to her expectation damages, even where the restitution damages would have been greater. So here, Rococo will be entitled to collect only the $50,000 contract price, not the $60,000 market value.

VII. SUBSTANTIAL PERFORMANCE AS A BASIS FOR SUIT ON THE CONTRACT

A. Substantial performance generally: As we said in the chapter on conditions (*supra*, p. 215), if one party fails to substantially perform his obligations, the other party is discharged from performing his duties.

The corollary to this rule is that where one party does substantially perform (i.e., does not materially breach), the other party is not relieved of his duties. If that other party refuses to perform, ***the substantially performing party has an action for breach of contract***.

1. **Rule:** To put the rule more simply, ***a party who substantially performs may sue for ordinary (expectation) damages for breach of contract if the other party fails to perform***. The other party has a set off, or counterclaim, for the damages she has suffered from the plaintiff's failure to completely perform the contract.

   a. **What constitutes substantial performance:** The factors that are considered in determining whether the plaintiff has substantially performed are discussed in detail *supra*, p. 227. The general principle is that the contract has been substantially performed where its ***"essential purpose"*** has been met.

      Example: P contracts to build a house for the Ds for $26,765. After most of the work has been done, the parties get into a dispute about the quality of the work, the Ds refuse to continue payment, and P doesn't finish the house. P sues for the balance of the contract price, and the Ds defend on the grounds that there has been no substantial performance. The Ds rely particularly on the argument that to redo and complete the work so that the contract specifications are matched would cost 25% to 30% of the contract price; they claim, for instance, that a wall has been placed so as to make the living room one foot narrower than it would have been, and that this would cost $4,000 to correct.

      Held, for P. "Substantial performance as applied to construction of a house does not mean that every detail must be in strict compliance with the specifications and the plans." The test is "whether the performance meets the essential purpose of the contract." Here, the house was built from stock floor plans, not plans specially prepared by the owner. Accordingly, deviations from the plans were not of great significance. The mis-locating of the wall by one foot did not affect the market price of the house, according to experts. Accordingly, there was substantial performance and P may recover on the contract (but D will have a counterclaim for damages). *Plante v. Jacobs*, 103 N.W.2d 296 (Wis. 1960). (For a discussion of the measure of damages applied in this case, see *infra*, 334.)

B. **Calculation of defendant's damages:** Where the plaintiff performs substantially but not completely, the ***defendant*** will always have a ***counterclaim*** for the ***damages she has suffered by virtue of the plaintiff's deviations.*** However, the calculation of these damages will vary from case to case; sometimes they will be pegged to the cost of remedying the defects, while at other times, they will be pegged to the diminution in value resulting from the deviations.

1. **Cost of remedying defect:** As long as the defects can be remedied without unreasonable economic waste, the defendant's damages are the ***cost of such remedial work.***

2. **Where waste involved:** If, on the other hand, the defects are so hard to correct that the cost of correction would be much greater than the increase in value resulting from the correction (i.e., the correction would involve unreasonable ***economic waste***), the defendant's damages are the difference between the ***value*** of the product which defendant ***would have received*** had the contract been completely performed, and the value of the product as ***actually rendered*** by the plaintiff. That is, the damages are equal to the ***diminution in value resulting from the deviations.*** (For more about courts' reluctance to award cost-of-correction where this would involve economic waste, see *supra*, p. 322.)

> **Example:** Assume the facts are those of *Plante v. Jacobs, supra,* p. 333. Since P has substantially performed, he is entitled to the contract price less the damages he has caused. D's damages should be measured ***not*** by the cost of ***making the house comply*** with the contract (i.e., cost-of-completion), but rather, the ***diminution in market value*** resulting from the breach. Particularly as to the wall built one foot in the wrong direction, tearing it down and rebuilding it would be "economic waste [that] is unreasonable and unjustified"; therefore, the cost of doing such repairs should not be awarded. As to the more trivial defects, such as plaster cracks in the ceilings, the cost of repair may be used by the court as an indication of the diminution in market value. *Plante v. Jacobs, supra*.

> **Note:** The means of calculating a defendant owner's counterclaim damages, discussed immediately above, are also the means by which the damages of an owner who is suing as plaintiff for a return of money he has paid to a defaulting contractor are calculated. Thus the measure of damages for the aggrieved owner is the same regardless of whether the owner is a plaintiff, or a defendant asserting a counterclaim.

C. Divisible contracts: If the contract is ***divisible*** into separate pairs of "agreed equivalents," a party who has substantially performed ***one of the parts*** may recover on the contract for that part. This is true even though he has materially (or even willfully) breached with respect to the other portions. For a more extensive discussion of the concept of divisibility, see *supra*, p. 221.

VIII. SUITS IN QUASI-CONTRACT

A. Situations where quasi-contract may be used: Thus far, we have treated cases in which the plaintiff sues "on the contract." There are a number of situations, however, where recovery on the contract is either impossible or as a matter of judicial policy not allowable. These situations may be grouped into four general classes:

[1] situations where there was ***never even an attempt to form a contract***, but the plaintiff nonetheless deserves some measure of recovery;

[2] cases where there was an attempt to form a contract, but the contract is ***unenforceable*** due to ***impossibility***, ***illegality***, ***Statute of Frauds***, etc.;

[3] cases in which there is an enforceable contract, but the plaintiff has ***materially breached***, and therefore may not recover on the contract; and

[4] cases in which the defendant has breached but for some reason the plaintiff is ***not entitled to damages on the contract.***

In each of these situations, the plaintiff will often be allowed to recover in what is called ***"quasi-contract."***

B. Measure of damages: Any of the three measures of damages is theoretically awardable in a quasi-contract suit. However, courts will almost never award expectation damages (except as a limit on a breaching plaintiff's restitution or reliance damages — see *infra*, p. 339). Both ***reliance*** damages and ***restitution*** damages are frequently awarded in quasi-contract suits; courts determine which measure to apply by looking at the facts of the particular case, and guessing which measure will better serve the "equities" of that case.

C. Quasi-contract where no contract attempted: The courts may as a matter of judicial policy award plaintiff a quasi-contractual recovery in some situations where ***no contract was even attempted***.

1. Rationale: Courts do this on the theory that "a person who has been ***unjustly enriched*** at the expense of another is required to ***make restitution***." Rest. (Restitution) § 1. A person (P) may recover on such a theory if she meets the following requirements:

[1] P ***rendered a benefit*** to another (D), who would be ***unjustly enriched*** if he were not required to pay for that benefit; and

[2] P did ***not*** confer the benefit on D ***"officiously,"*** that is, she did not thrust the benefit upon D ***against his will*** or in circumstances where she should have known that D would not want the benefit; and

[3] P did ***not*** confer the benefit on D ***"gratuitously,"*** i.e., ***without expectation of compensation***.

Farnsworth, § 2.20.

2. **Emergency services supplied:** The most common example of recovery in quasi-contract where there has not even been an attempt at contract formation is the situation in which the plaintiff supplies ***emergency services*** to the defendant, without first forming a contract to do so.

> **Example:** D is injured in a streetcar accident, and is unconscious. A bystander summons P, a doctor, to give D emergency medical aid. P performs a difficult operation and D dies.
>
> *Held*, P may recover, in quasi-contract, the reasonable value of his services, even though there was never any attempt to negotiate a contract. In determining the reasonable value of these services, the fact that D died, and thus did not receive any real benefit, is irrelevant. Nor may the jury consider D's financial condition in determining the value of the services; this value should be determined by expert testimony as to the usual charge for such services. *Cotnam v. Wisdom*, 83 Ark. 601 (1907).

a. **Terminology:** Where no contract exists between the plaintiff and the defendant, plaintiff's recovery is sometimes called recovery on a ***"contract implied-in-law."*** This terminology is confusing, however, so we'll say, instead, that the plaintiff is permitted to recover ***"in quasi-contract."*** Keep in mind that a "quasi-contract" is ***not a contract at all*** — it is an obligation ***imposed by law*** in order to bring about justice and equity.

b. **No recovery where contract with another exists:** A plaintiff will not usually be allowed to recover in quasi-contract for benefits conferred on the defendant if a ***third person*** was under contractual obligation to pay for those benefits.

i. **Sub-contractors:** The rule that there can be no quasi-contract recovery against the defendant where the services were contracted for by a third person means that a ***sub-contractor*** on a building job (i.e., someone hired by the general contractor to do a particular piece of the work) ***cannot sue the owner*** of the building for the reasonable value of the work done, even if the general contractor is unable to pay. (But statutes in most states give a ***mechanic's lien*** to the sub-contractor, so that she can force a judicial sale of the property, and recover the value of her services from the sale proceeds. See F&Y, p. 83, Note 3.

c. No recovery if intended as a gift: Also, there will usually be no recovery if the facts indicate that the service-provider ***did not expect to receive payment***, and intended instead to ***make a gift*** of the services. (This is requirement [3] on p. 335 *supra*, the requirement that P not have conferred the benefit "gratuitously.")

Example: Aunt and Nephew go on a picnic lunch together. Nephew takes a swim in a lake, and starts to drown. Aunt jumps in, rescues Nephew, and in so doing ruins her valuable watch. Aunt will probably not be able to recover from Nephew in quasi-contract for the value of the watch, because the Aunt-Nephew familial relationship indicates that Aunt did not expect to be paid for her emergency services.

D. Unenforceable contracts: The parties may attempt to form a binding contract which turns out to be ***unenforceable*** or voidable because of the ***Statute of Frauds***, ***mistake***, ***illegality***, ***impossibility***, or ***frustration of purpose.*** In such a situation, the court will normally allow the plaintiff to sue in quasi-contract, and recover either the ***value of the services performed*** (restitution) or the plaintiff's ***reasonable expenditures*** (reliance). Restitutionary damages are probably the more common measure.

Example: P, a contractor, contracts to remove a wooden floor from defendant's warehouse, and to install a reinforced concrete floor in its stead. He removes the old floor, installs reinforced steel rods to support the concrete, and places temporary wooden forms that are to hold the concrete until it has dried. Before the contract is completed, fire destroys the warehouse, without either P's or D's fault.

Held, P is discharged from completing the contract by the doctrine of impossibility. P may, furthermore, recover in quasi-contract for those expenditures which benefited D (i.e., removal of the wooden floor, and installation of the steel rods). P may not recover for the temporary wooden forms, since these were merely incidental preparations for P's performance, and did not directly benefit D. Thus P's quasi-contractual recovery here includes restitution, but not reliance, damages. *Carroll v. Bowersock*, 100 Kan. 270 (1917).

E. Quasi-contractual recovery by a breaching plaintiff: Where a plaintiff has substantially, but not completely, performed, he may, as we have seen (*supra*, p. 333) recover on the contract, with an allowance to the defendant for damages for the non-material breach. But what if the plaintiff's performance is ***not substantial***, but the defendant has nonetheless been benefited by the plaintiff's performance? Does the plaintiff forfeit everything he has done? At least where the plaintiff's breach was not "willful," the answer is "no" — the plaintiff may recover his ***restitution interest***, less the defendant's damages for the breach. Such recovery is sometimes said to be in ***"quantum meruit"*** ("as much as he deserves").

> **Example:** P agrees to work for one year for D, for $120, to be paid at the end of the year. P works for 9 1/2 months and then quits without justification.
>
> *Held*, P may recover the reasonable value of the services he performed. (This was found by the jury to be equal to the pro-rata contract price). If P were not allowed to recover anything, D would end up having gotten almost five-sixths of the value of the whole year's labor for free; this would be much more than D could possibly have sustained in the way of damage from the breach. It is true that in an employment contract, the employer has no ability to return the part performance once it has been rendered, as a seller of goods, say, could reject a smaller shipment than ordered or a defective shipment; in this sense, it is not quite as fair to require the employer to pay for the defective performance as it is to require the buyer to pay the reasonable value of a defective tender which he has nonetheless kept. But in the labor case, the employer may be said to have accepted ***in advance*** the possibility that there would be only part performance, so the cases are not really distinguishable. (However, P may recover only the benefit conferred upon D; this cannot exceed the pro-rata contract price, less the damages from the breach.) *Britton v. Turner*, 6 N.H. 481 (1834).

1. Use in construction cases: One frequent application of the doctrine allowing quasi-contractual recovery by a defaulting plaintiff occurs in ***construction*** cases, in which the builder has constructed something that fails to constitute substantial performance but which is nonetheless of value to the owner.

a. Right to recover value to owner: In this situation, the builder gets to recover the ***value to the owner*** of the work done, even where the work does not constitute substantial performance of the contract.

i. **Lesser of "cost to owner" and "change in value to owner":** When the court measures the "value to the owner" of the builder's work, courts want to avoid unduly rewarding the breaching builder. Therefore, the court will typically award the breaching builder the ***lesser*** of:

- ☐ the amount by which the ***value of the owner's property has been increased*** due to the work; and
- ☐ the reasonable ***cost to the owner*** if the owner had had that work done by someone other than the breaching builder.

See Rest. 2d, §§ 371, 374(1).

Example: Ohn, a homeowner, contracts with Builder 1 to have Builder 1 renovate Ohn's kitchen. The contract price is $100,000, to be paid at the end of the job. Builder walks off the job without justification when the work is half done. Ohn gets the job completed for $50,000 by Builder 2. It would have cost Ohn $50,000 to have had Builder 2, or anyone else, do the first 50% of the job (the work done by Builder 1 before he walked off the job). But the completed renovation increases the value of Ohn's home by $150,000 (and even the first 50% of the job increased the value of the home by $75,000).

Even though Builder 1 did not "substantially perform" (doing half the job is not substantial performance), Builder 1 can recover in quasi-contract from Ohn for the reasonable value to Ohn of the work Builder 1 did. But in measuring the "reasonable value to Ohn," the court will take the lesser of (1) the increase in value of the home due to Builder 1's work ($75,000) and (2) the reasonable cost that Ohn would have incurred had he had someone other than Builder 1 do the first 50% of the job ($50,000). So Builder 1 will recover only the $50,000, and Ohn in a sense gets a windfall.

2. **Payments made by party in breach:** Quasi-contractual recovery may also be allowed where the benefit conferred by the breaching party consists of ***money paid*** by him. While the courts have been slower to allow recovery in this situation than in the context of furnishing of services (exemplified by *Britton v. Turner, supra,* p. 337), the modern tendency is clearly to ***allow*** such recovery.

   a. **Land-sale contracts:** The most common illustration of a breaching plaintiff's quasi-contractual right to recover money payments is the ***installment land-sale contract***.

Example: P contracts to buy a tract of land from D for a price of $1,500, payable in installments. The contract contemplates that the land will not be conveyed by D to P until the last payment has been made. Ten months after all payments should have been made, P has paid only $1,070 of the purchase price. D then conveys the property to a third person for $1,300, but refuses to refund any of the money paid by P. P brings an action in quasi-contract.

Held, P may recover $870 in quasi-contract. Payments of this amount by D will put D in the position he would have been in had the contract been fulfilled (since he will have received a total of $1,500 in return for the land). That is, P is entitled to recover the benefits he has conferred on D ($1,070 of payments) less the damages D has suffered by the breach (i.e., resale for $1,300 rather than the $1,500 contract price). Adherence to the traditional rule denying recovery to one in P's position would produce the "surprising result … that a purchaser who pays a substantial portion of the purchase price before defaulting is in a much worse position than the purchaser who pays nothing.…" *DeLeon v. Aldrete*, 398 S.W.2d 160 (Tex. Civ. App. 1965).

b. Retention of money as liquidated damages: There is an important exception to the general right of a breaching plaintiff to recover payments he has made: where the contract ***explicitly provides*** that these payments are to be ***retained by the other party*** in case of breach, the court will ***honor*** this agreement, if the sum is a "reasonable one that would be sustained as liquidated damages had the parties stipulated it." Farnsworth, p. 877. The "reasonableness" of the sum is measured "in the light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss." Rest. 2d, § 374(2). (See also the discussion of liquidated damages clauses *infra*, p. 356.)

Example: On the facts of *DeLeon v. Aldrete*, *supra*, assume that the contract explicitly provided that any payments made by P would be retained by D in the event of P's breach. Had P only paid, say, 20% of the $1,500 contract price by the time of breach, a court might well find that this amount constituted reasonable liquidated damages in view of possible difficulties of proof of loss; if so, it would allow D to keep the $300, even though D's actual loss turned out to be only $200. But it is highly unlikely that the court would find that the sum of $1,070 (the amount actually paid by P in the case, equalling more than two-thirds of the contract price) was a reasonable liquidated damages amount; therefore, the court would strike the entire retention-of-payments provision, and would require D to return all but his actual damages.

3. Limited to pro-rata contract price: Where the plaintiff is not in default, he may, as we have seen (*supra*, p. 331) sue on the contract to recover his restitutionary interest; as long as the plaintiff has not fully performed, his recovery is not limited to the pro-rata contract price, or even to the total contract price. Where the plaintiff is in default, however, the courts have been very strict in limiting the plaintiff's quasi-contract restitution-interest recovery to the ***pro-rata contract price***, less the defendant's damages for breach. The reason for this limitation is that otherwise, the plaintiff would be able to ***"profit by his own wrong."***

Example: P, a contractor, agrees to build a house for O for $200,000. P performs 70% of the work, and expends $160,000 in doing so; he then becomes insolvent. The partially completed house is worth $180,000 on the open market. P finds another contractor, X, to complete the work for $60,000, but O suffers a $10,000 loss due to rental payments which he has to make, because P's breach has delayed his being able to occupy the house. P, although he is in material breach of the contract, may recover in quasi-contract.

However, his recovery, though it is based on restitution (the $180,000 benefit conferred on O), is limited to the pro-rata contract price ($140,000) less O's damages from the breach ($10,000), or $130,000. If the partially completed house had had a market value of $120,000, rather than $180,000, P's recovery would have been $120,000 minus $10,000, or $110,000. That is, the benefit conferred on the defendant, or the pro-rata contract price, whichever is less, serves as the basis for the damage award; from this is subtracted the defendant's counterclaim for damages due to the breach. (Note that P's reliance interest, the $160,000 spent in performing, is irrelevant.)

4. **"Willful" default:** In many jurisdictions, the defaulting plaintiff will be allowed to recover in quasi-contract ***only if her breach is not "willful."*** If the plaintiff's breach is willful, in these jurisdictions ***she cannot recover anything at all***. A willful breach is one which is intentional, rather than accidental or negligent. See Farnsworth, p. 577.

   a. **Second Restatement view:** The Second Restatement (in contrast to the First) does not explicitly bar quasi-contract recovery if the breach is "willful." Rest. 2d, § 374. However, Comment b to § 374 seems to accomplish the same result as a ban on recovery by willfully breaching plaintiffs, when it says that "a party who intentionally furnishes services or builds a building that is materially different from what he promised is properly regarded as having ***acted officiously*** and ***not in part performance*** of his promise and will be denied recovery on that ground even if his performance was of some benefit to the other party."

   b. **Convenience or financial advantage:** Courts are especially likely to deny recovery if the breach is not only intentional, but made in ***bad faith***. For instance, a ***contractor*** who ***uses cheaper materials*** in order to make an already profitable contract more profitable is less likely to be granted quasi-contractual recovery than a contractor who uses cheaper materials because he has underbid the job and will incur grievous losses on it if he does not make the change.

c. Employment contracts: Courts are less likely to treat "willfulness" as a bar to recovery in the context of ***employment contracts*** than in connection with most other types of contracts. For instance, *Britton v. Turner, supra*, p. 337, was such a case, since the plaintiff's decision to quit was clearly "intentional."

i. **Statutory modifications:** Even where there is no judge-made rule allowing willfully-breaching employees to recover, recovery may be facilitated by ***statute***. Many states today have statutes which require that an employee be paid wages at specified intervals, and which allow the employee to recover for those periods which have already expired, when he wrongfully quits. (Also, the doctrine of ***divisibility*** may produce a comparable result; see *supra*, p. 221.) Even where a statute allows partial recovery, however, the employer has a ***counterclaim for damages*** which he sustained by reason of the employee's breach.

5. UCC allows partial restitution to breaching buyer: The UCC gives a ***breaching buyer*** a right to ***partial restitution*** with respect to ***payments he made to the seller*** before he (the buyer) breached. UCC § 2-718(2) provides that:

> "where the seller justifiably withholds delivery of goods because of the buyer's breach, the buyer is entitled to ***restitution*** of any amount by which the sum of his payments ***exceeds (a)*** the amount to which the seller is entitled by virtue of [an enforceable ***liquidated damages*** provision] or ***(b)*** in the absence of such [a provision], ***twenty percent*** of the value of the total performance for which the buyer is obligated under the contract or ***$500***, whichever is ***smaller***."

> **Example:** Seller contracts to sell to Buyer 1,000 widgets at $2 each. The contract does not contain a liquidated damages clause. Buyer sends in a $700 deposit. Buyer cancels the order just before Seller is to ship. Seller suffers no damages, because he has a limited supply of the widgets, and sells the ones he had earmarked for Buyer to X instead, at the same price.
>
> Even though Buyer has breached, Seller may not keep the entire $700 deposit. Instead, Seller is entitled to keep only the lesser of: (i) 20% of the contract price ($400) and (ii) $500. Therefore, Seller may keep only $400, and must refund the other $300.

a. Seller's counterclaim: But where the buyer establishes such a right to restitution, the seller may ***offset*** the buyer's claim by any ***actual damages*** which he sustained as a result of the buyer's breach (computed by using Article 2's regular damages measures). § 2-718(3). So the seller owes the buyer a refund of the deposit in excess of the lesser of 20% of the contract price and $500, but can subtract from this refund seller's actual damages.

Example: Buyer agrees to buy a $10,000 widget from Seller, and gives Seller a $4,000 deposit. The contract does not contain any liquid damages provision. Before the date for delivery, Buyer says, "I don't want the widget — cancel my order." Let's assume that Seller cannot show actual damages, because he resells the widget to someone else for the same price, and that was the only widget Seller had or could get. In this situation, § 2-718(2) requires Seller to return the deposit minus the lesser of 20% of the contract price (i.e., $2,000) or $500; therefore, Seller must refund $3,500 to Buyer.

But now, assume that Seller is a "lost volume" dealer, i.e., he can get as many widgets as he has orders for. Assume also that Seller's cost per widget is $7,000. On these facts, Seller will be able to show that under the UCC's regular computation-of-damages measures, he has suffered actual damages of $3,000 by virtue of Buyer's cancellation, since even if Seller sells the particular widget earmarked for Buyer to someone else for the same $10,000, Seller will end up with $3,000 in overall lost profits by virtue of having done one less transaction. (See § 2-708(2), discussed *infra*, p. 369, dealing with "lost volume" sellers.) Therefore, under § 2-718(3)(a) Seller must refund only $1,000 to Buyer, and can keep the remaining $3,000 as actual damages.

F. Plaintiff not entitled to contract damages: In some cases, a contract exists and the defendant has breached, but the standard expectation measure damages produces no recovery for the plaintiff. In such instances, if the plaintiff has ***conferred a benefit*** on the breaching party, many courts will allow the plaintiff to recover the ***fair value*** of any goods or services he has conferred upon the defendant, even though such a recovery puts the plaintiff in a better position than the expectation measure would have. Farnsworth, p. 856-57. This topic is discussed more fully above. See, e.g., *U.S. v. Algernon Blair, Inc.*, discussed *supra*, p. 332.

Quiz Yourself on
SUITS IN QUASI-CONTRACT

94. Plato agrees to build a gazebo on Agamemnon's property in Pompeii, in return for $25,000. Plato spends $10,000 on materials and labor before Agamemnon's property is buried in lava from the Mount Vesuvius eruption. At the moment of the eruption, the partly-completed gazebo

had a market value of $15,000. Will Plato be entitled to anything? If so, on what theory, and in what amount?

95. Dr. Welby is walking down the street when he sees a car hit Old Man River. Old Man River is lying unconscious in the street. Dr. Welby runs over and immediately begins CPR. He then pulls out his Swiss Army Knife, sterilizes it with a match and performs emergency surgery, saving Old Man River's life. Dr. Welby is a high-class Beverly Hills doctor who would normally charge $4,000 for the type of work he performed on Old Man River. The reasonable (market) value for this type of services, however, is $2,000. Dr. Welby sends Old Man River a $4,000 bill. Old Man River refuses to pay, arguing he never consented to have the work done and would not have done so had he been conscious at the time. Dr. Welby sues. How much, if anything, can Dr. Welby recover?

96. Scarlett O'Hara contracts to have Wilkes Construction to build a dream home for her, for a total cost of $1 million. The specifications include clay bricks and leaded glass windows. Wilkes decides to increase his profit margin a little by using plastic bricks and plain window panes; he figures Scarlett won't notice. When the work is about one-eighth done (and Wilkes has made outlays of $75,000), Scarlett notices the sub-standard work, and cancels the contract. It is not feasible to restore the house to the contracted-for specifications, since the bricks cannot be replaced without essentially demolishing what has already been built. The market value of the partly-completed house is $100,000. Scarlett has not paid anything yet on the contract price. If Wilkes sues Scarlett for the partly-done work, what (if anything) can he recover, and on what theory?

Answers

94. Yes, in quasi-contract, probably for $15,000. Where impossibility prevents the fulfillment of a partially-performed contract, the court will normally allow the party who has performed work to recover in quasi-contract. The court will choose between reliance damages (here, $10,000) and restitution damages (here, $15,000). Probably the court will allow restitution, even though Agamemnon got no *lasting* benefit from the gazebo — the court will likely reason that Agamemnon received a temporary benefit worth $15,000, and that he could have (and should have) carried insurance to cover the value to him of partly-completed construction work.

95. **$2,000.** Dr. Welby cannot recover his expectation damages ($4,000) because no contract was ever attempted under these facts. He can, however, recover the reasonable value of his services ($2,000) in quasi-contract. It is irrelevant that Old Man River claims after-the-fact that he didn't want the services performed — in emergency situations, the person who provides the services with a reasonable expectation of being compensated for them will be able to recover the reasonable value of the services.

96. **Probably nothing.** A plaintiff who materially defaults is not by that fact alone prevented from recovering; he will usually be permitted to recover in quasi-contract for the market value of the partial performance. But in most jurisdictions there is an exception: if the plaintiff willfully (i.e., intentionally) breaches, courts will often deny *all* recovery, especially where the breach was done to save money, and done in a deceptive manner. Wilkes' motive to save money by substituting inferior materials would fall into this category, so Wilkes will probably be denied all recovery. This is especially likely since there is no way for Scarlett to pay a reasonable amount to have the work transformed to something that meets her specifications.

IX. FORESEEABILITY

A. **General limits on consequential damages:** In the ordinary breach of contract situation, the court will attempt to protect the plaintiff's expectation interest; that is, the court will try to put the plaintiff in the position she would have been in had the contract been performed. In some situations, however, the plaintiff may sustain ***unusual and great losses*** as the result of a breach of contract. The sender of a telegram, for example, may lose a million dollar deal if the telegraph company mistransmits her bid. The courts have for a long time realized that to award the plaintiff full compensation for all of her losses due to the breach, no matter how bizarre or unforeseeable these losses are, would simply be unfair to the defendant, and possibly paralyzing to commerce as well. Therefore, the courts have developed certain limits on the kinds of damages which the plaintiff may recover.

B. ***Hadley v. Baxendale:*** The rules limiting the kinds of damages for which the plaintiff may recover are derived from the famous English case of ***Hadley v. Baxendale***, 156 Eng. Rep. 145 (1854).

1. **Facts of *Hadley*:** Plaintiffs operated a mill which was forced to suspend operations because of a broken shaft. An employee of the plaintiffs took the shaft to the defendant carrier for shipment to another city for repairs. The carrier knew that the item to be carried was a shaft for the plaintiff's mill, but was not told that the mill was closed because the shaft was broken. The carrier negligently delayed delivery of the shaft, with the result that the mill was closed for several more days than it would have been had the carrier adequately performed the contract. Plaintiffs sued for the profits they lost during these extra days.

2. **Holding:** The court held that plaintiff could not recover for the lost profits. The loss of profits was not a consequence which "in the usual course of things" flows from a delay in the shipment of a shaft.

3. **The two rules of *Hadley:*** The court in deciding *Hadley* stated that a plaintiff suing for breach of contract may recover only damages which fall into one of two classes. These two classes are known today as the two "rules" of *Hadley v. Baxendale*. The damages must either:

   a. arise "***naturally,*** i.e., according to the ***usual course of things***, from [the] breach of contract itself.…" or

   b. arise from "the ***special circumstances*** under which the contract was actually made" if and only if these special circumstances "were ***communicated*** by the plaintiff to the defendants.…"

4. **Reformulation of rule:** Another way to express the two classes of damages allowed in *Hadley* is as follows:

   a. The court will ***"impute" foreseeability*** to the defendant as to those damages which any ***reasonable person should have foreseen***, whether or not the defendant actually foresaw them; and

   b. The court will also award damages as to ***remote or unusual consequences***, but only if the defendant had ***actual*** notice of the possibility of these consequences.

5. **Application of facts of *Hadley*:** The lost profit sought by the plaintiffs in *Hadley* did not fall into either of these two categories. That an enterprise might be shut down for lack of a shaft would not normally be foreseen by one in the position of the defendant carrier; therefore, the damages did not fall in the first class of "general" or "ordinary" damages. Nor did the plaintiffs give the defendant notice of the possibility of the shutdown of the mill; therefore, the damages did not fall in the second class. (The official head-notes to the case state that the defendant was told that the mill was shut down, but the opinion itself assumes that such notice was not given).

C. **Universally followed:** The rule of *Hadley v. Baxendale* is ***followed*** almost ***universally*** by American courts. See Rest. 2d, § 351.

1. **Nomenclature used by courts:** The courts have often called damages falling under the "first" rule of *Hadley v. Baxendale* ***"direct"*** or ***"general"*** damages. Damages falling under the second rule are usually called ***"special"*** or ***"consequential."***

2. **Factors bearing on unforeseeability:** In determining whether particular damages are "reasonably foreseeable," and therefore fall under the first rule of *Hadley v. Baxendale*, the courts consider such factors as the separation in time and space between the breach and the consequences, customs in the plaintiff's and defendant's trades, etc.

3. **Parties may allocate risks themselves:** The parties are, of course, free to ***allocate the risks*** by express agreement in a way different from that prescribed by *Hadley v. Baxendale*. One way they can do this, of course, is for the plaintiff to give notice to the defendant of special circumstances, thus bringing the situation within the second rule of *Hadley*. Alternatively, the parties may agree that the defendant will not be liable for certain "reasonably foreseeable" consequences which would otherwise fall within the first rule of *Hadley*.

   Example: Telegraph Company makes every sender of a telegram sign a contract which provides that any remedy for mis-transmission of the message shall be limited to refund of the price of the telegram. This allocation of risk will probably be enforced by a court, even though in particular cases it will be obvious to Telegraph Company from the content of the message that substantial loss would result from mis-transmission.

4. **Knowledge of consequential damages necessary:** Under the second rule of *Hadley v. Baxendale*, damages other than those arising "naturally" are recoverable only if the defendant had ***reason to know the special circumstances*** which would give rise to these consequential damages. (See Rest. 2d, § 351(2)(b).) Two special situations are worth considering in detail:

   a. **Contract to lend money:** Where the contract calls for the defendant to ***lend money*** to the plaintiff, courts will usually presume that money is an "available commodity" which can be obtained from another source at the market rate of interest. Therefore, ordinarily, the injured borrower will only be able to recover the difference between the market rate of interest and the rate called for in the contract (if the latter is lower) even if the borrower can't in fact borrow elsewhere. But if the borrower can show that the lender was ***aware*** that the borrower would likely have a hard time borrowing from other sources, then more extensive damages may be recovered (e.g., profits that the borrower would have made with the borrowed money, if the lender is shown to have been on notice of the use to which the funds would be put). Farnsworth, pp. 827-28.

   b. **Liability to third party:** A breach of contract may sometimes cause the injured party to become ***liable to a third party***. If this third-party liability was foreseeable to the breaching party at the time the contract was made, the injured party may recover for this liability. For instance, if a seller of goods knows that the buyer has a contract to resell the goods, the seller will be liable for damages which the buyer is forced to pay to his own purchaser. Furthermore, the seller will be liable for the buyer's reasonable ***litigation expenses***, and for the amount of any reasonable and foreseeable ***settlement*** which the buyer makes in order to avoid litigation. Farnsworth, p. 828.

5. **Foreseeability distinguished from certainty:** It is important to distinguish between the question whether particular damages were ***foreseeable*** (which is the *Hadley v. Baxendale* problem) and the question whether particular damages can be proved with adequate ***certainty*** (a question which is discussed *supra*, p. 323). Foreseeability

relates to whether the possibility of the damages was sufficiently likely at the time the contract was made. Certainty, on the other hand, relates to how clear it is ***at the time of suit*** that the alleged losses in fact occurred, and that they were caused by the defendant's breach.

6. **Time for measuring foreseeability:** Whether particular consequences were sufficiently foreseeable must be determined ***as of the time the contract is made***. If the defendant acquires knowledge of possible consequences after the contract is formed, but before the defendant breaches, this knowledge is ***irrelevant***. Farnsworth, § 12.14; Rest. 2d, § 351.

7. **UCC rule is liberal:** The UCC applies a fairly liberal (from the plaintiff's perspective) view of *Hadley v. Baxendale*. § 2-715(2) allows a buyer to recover "***consequential damages*** resulting from the seller's breach," defined to include "any loss resulting from ***general or particular requirements*** and needs of which the seller at the time of contracting ***had reason to know*** and which ***could not reasonably be prevented by cover or otherwise,***" as well as "injury to person or property proximately resulting from any breach of warranty." Comment 3 notes that "particular needs of the buyer must be generally made known to the seller while general needs must rarely be known to charge the seller with knowledge." Thus both rules of *Hadley v. Baxendale* are in effect applied.

   a. **Failure to deliver:** If the seller fails to deliver the goods at all, the buyer who ***"covers"*** (i.e., procures substitute goods; see *infra*, p. 365) may recover the amount by which the cost of cover exceeds the contract price, plus any costs of arranging the covering transaction. These losses are viewed by the Code as being "ordinary course" losses, and the seller must pay them even though he had no special knowledge. (This rule applies even where the spread between cost of cover and contract price is large, due to a sudden and extreme increase in market prices.)

   b. **Inability to cover:** Problems of foreseeability arise only where the buyer is ***unable to cover***. The Code assumes that in our market-based system the buyer will normally be able to procure substitute goods. Therefore, damages from inability to cover will be deemed foreseeable only if the seller was "aware of facts making the buyer's inability to cover itself foreseeable." Farnsworth, p. 827.

i. **Goods for resale:** Consider the special case where the buyer is a ***middleman***, i.e., one who intends to resell the goods for a profit. If the buyer is unable to cover, and assuming that this inability to cover was itself foreseeable to the seller (see the preceding paragraph), the seller will be held to have foreseen the possibility of lost profit as long as he knew that the buyer intended to resell. Farnsworth, p. 827-28. However, the seller will not be liable to the extent that the profits lost by the buyer are ***extraordinarily large***. *Id*.

ii. **Buyer is manufacturer:** If the buyer is not a middleman, but rather a ***manufacturer*** who is buying the item in order to use it to produce goods or services which will be resold for profit, a similar analysis applies. That is, in order to recover his lost profits, the manufacturer/buyer must first show that his inability to cover was foreseeable to the seller, and must then show that the ***seller had reason to know that the buyer would be using the item to produce goods and services.*** Even after all this is shown, recovery will not be allowed for lost profits that are ***larger than the seller had reason to anticipate.*** Farnsworth, p. 828.

c. **Breach of warranty:** Where an action is based upon breach of ***warranty*** (as opposed to the seller's failure to deliver the goods at all), the foreseeability rule is even more lax. Any injury to person or property may be recovered for, as long as it was ***"proximately" caused*** by the breach of warranty. (A breach of warranty action may in some jurisdictions be brought not only by the buyer, but by any person injured by the breach of warranty. Privity requirements for breach of warranty actions are discussed in the chapter on Warranties, *infra*, p. 501.)

i. **Lost profits:** Many courts have allowed ***lost profits*** due to defective goods.

d. **Limitation of damages by parties:** Under the UCC (as under the non-Code law of most states), the parties are given substantial latitude to ***modify*** their liability for consequential damages. § 2-719(3) provides that "consequential damages may be limited or excluded unless the limitation or exclusion is ***unconscionable***."

i. **General rule on unconscionability:** The section goes on to state that limitation of consequential damages for ***injury to the person*** in cases of consumer goods is "prima facie ***unconscionable***," and that limitation of damages where "the loss is ***commercial***" is ***not*** prima facie unconscionable. The section does not state anything about unconscionability where injury to the person resulting from commercial goods is involved, nor where economic loss to a consumer is involved. See the discussion of damages for breach of warranty, *infra*, p. 373.

8. **Buyer who has to pay liquidated damages to third party:** ? Suppose the plaintiff and defendant contract for the defendant to supply the plaintiff with some good or service needed for the plaintiff's business, and the plaintiff in reliance ***makes a separate contract with a third party that contains a liquidated damages provision.*** Let's assume the defendant's breach causes the plaintiff to be ***unable to perform the other contract,*** so that the plaintiff has to pay off on the other contract's liquidated damages clause. The question then becomes, do the plaintiff's damages include the cost of this liquidated-damages payment to the third party?

   a. **Probably no liability:** The answer will usually be ***"no."*** Unless the defendant had specific knowledge of the plaintiff's liquidated-damages deal on the third-party contract, the defendant will get the benefit of *Hadley v. Baxendale*. In other words, such a liquidated-damages clause does not come within the category of "general" or "ordinary" damages that would be reasonably foreseeable to a breaching seller who didn't have specific knowledge of the clause.

X. AVOIDABLE DAMAGES

A. **General rule:** All courts agree that where a plaintiff ***might have avoided*** a particular item of damage by reasonable effort, without undue risk, expense, or humiliation, ***he may not recover for that item if he fails to make such an effort.*** Rest. 2d, § 350. This rule arises from courts' desire to treat the breaching party fairly, and the desire to avoid economic waste.

1. **"Duty to mitigate":** The rule preventing recovery for avoidable damages is often called the ***"duty to mitigate"*** rule. However, the plaintiff does not have any "duty" in the sense of an obligation for noncompliance with which judicial sanctions may be issued. If the plaintiff does not avoid his avoidable damages, he simply loses his ability to recover for them and nothing further happens. Rest. 2d, § 350, Comment b.

> **Example:** P contracts to have D build a bridge. Midway through construction, D tells P that it does not regard the contract as valid, and that P should not proceed any further. P nonetheless completes the bridge, and sues for the contract price.
>
> *Held*, P may not recover for any damages incurred after the stop-work order. "A plaintiff cannot hold a defendant liable for damages which need not have been incurred.…" *Rockingham County v. Luten Bridge Co.*, 35 F.2d 301 (4th Cir. 1929).

B. Standard of reasonableness: The avoidable damages doctrine merely requires the plaintiff to make ***reasonable efforts*** to mitigate damages. The plaintiff is not expected to enter into dubious contracts, incur considerable expense or inconvenience, disorganize his business, damage his reputation or honor, or break any other contracts, in order to mitigate the damages done by the defendant's breach. Rest. 2d, § 350, Comment g.

> **Example:** Inventor contracts to invent, design, and produce a machine to be used by D in the latter's business. Inventor makes contracts with several suppliers for the parts which she will need to design and produce the machine. Before delivery of these parts, D repudiates the contract. Inventor may accept delivery of the parts, and recover the contract price less any costs saved by not having to perform (e.g., any resale value of the parts). She is not required to break her contracts with the suppliers, in order to mitigate her damages.

1. **Personal service contract:** Where the contract is for ***personal services***, courts are especially lenient toward the plaintiff, and do not require him to accept any position that is ***substantially different from***, or inferior to, the one contracted for.

> **Example:** P (Actress Shirley MacLaine) contracts to perform in a movie musical to be made by D, called "Bloomer Girl." She is to be paid a salary of $750,000, and her contract provides that she has approval rights over the director and the screenplay. D then cancels the contract, but offers to pay P the same salary for a different movie, "Big Man." In this movie, she would not have approval over

director or screenplay; also, the movie is a "Western Type" rather than a musical, and will not show P's dancing talents as the other one would have.

Held, the second movie constituted a "different and inferior" employment from the first, and P was not required to accept it in order to mitigate damages. It was different in that it was a western rather than a musical, and did not involve P's dancing and singing talent. It was inferior in that it lacked director and screenplay approvals. Furthermore, the court will not inquire whether P acted reasonably in rejecting the second offer; the sole question is whether she made reasonable ***efforts*** to procure employment that was substantially the same as the canceled work. *Parker v. Twentieth Century Film Corp.*, 474 P.2d 689 (Cal. 1970).

(A dissent argues that the two employments did not have to be identical for P to be required to accept the second one; it should be enough if they were of substantially the same kind, and there was no showing here that this was not so. Otherwise, a dismissed employee would never be forced to mitigate unless he were offered precisely his old job back by his old boss.)

a. **Offer of re-employment by D:** Suppose an offer of "substitute employment" ***comes from the defendant itself.*** That is, suppose that after the defendant wrongfully fires the plaintiff, the defendant offers either to ***reinstate*** the plaintiff in her old job, or to employ her in a ***new, substantially equivalent, position***. (Observe that this is what D claimed happened in *Parker*, *supra*.) In deciding whether the plaintiff's rejection of this offer of re-employment constitutes a failure to mitigate, is there anything legally significant about the fact that the offer is ***coming from the same (breaching) employer?*** The answer will depend on the circumstances, but is usually "yes": as a general rule, courts are sympathetic to the plaintiff if she declines the offer in the belief that there will ***inevitably be ill-will between the parties stemming from the prior breach.***

i. **Rationale:** As one court put it, the employee's rejection of an offer of re-employment will not diminish the employee's recovery for breach "if [the] circumstances are such as to ***render further association between the parties offensive or degrading to the employee,***" which the court found to be likely in that particular breaching-employer situation. *Voorhees v. Guyan Machiney Co.*, 446 S.E.2d 672 (W.Va. 1994).

C. **Burden of proof on defendant:** Who should ***bear the burden of proof*** on the factual issue of whether the plaintiff made the required reasonable efforts to mitigate her damages? In both employment and nonemployment scenarios, most courts ***place the burden on the defendant.*** That is, courts generally view the so-called duty to mitigate as an ***affirmative defense***, and therefore impose on the breaching party the obligation to produce evidence that the non-breaching party / plaintiff failed to mitigate.

1. **Employment cases:** In employment cases where the plaintiff is an employee whose contract the employer has wrongfully breached, courts' tendency to place the burden of proof on the defendant employer is often of critical importance. In such cases, the employer is usually required to make an affirmative showing of both of the following propositions:

   [1] That the employee ***failed to act reasonably in seeking substitute employment***; *and*

   [2] That there was at least ***one comparable position*** that the employee would likely have ***obtained*** had she made reasonable efforts to do so.

   See K,C&P, p. 906.

   a. **No effort to find alternatives:** Notice that if the court follows the usual approach and places on the defendant employer the burden of proof as to both of the above propositions, the employer cannot succeed with the mitigation defense unless the employer proves step [2], that a ***suitable replacement position existed*** that the employee would likely have found and obtained.

      i. **D must show alternative jobs and their compensation:** In fact, even if the employer shows that the employee ***made absolutely no effort to find another comparable position***, in most courts the employer will ***lose*** on the mitigation defense unless the employer *also*, with some specificity:

         □ ***identifies one or more positions*** that the employee would likely have succeeded in obtaining, *and*

         □ shows ***how much the employee would have earned*** had she been offered and taken one of these suitable replacement positions.

      It is often quite difficult for the employer to make both of these detailed showings, especially the second one — that's why, at least in employment cases, the breaching employer tend not to fare very well with the duty-to-mitigate defense.

Example: P owns and runs a woodworking business. He sells the business to the Ds. As part of the sale transaction, he signs a three-year employment contract with the Ds by which he will continue to work in the business. Six months into the employment contract, the Ds fire P in what the court later finds to have been a breach of contract. P does not look for substitute employment, and sues the Ds for the entire salary that he would have earned between the firing date and the end of the three-year term. D demonstrates that P never made any efforts to find substitute employment. But D does not produce any evidence of what specific suitable alternative jobs would have been available to P, and thus shows no evidence as to how much any such substitute job would have paid P. The trial court finds that, although the Ds breached the contract by firing P, P's failure to make any effort to find substitute employment automatically means that P failed to mitigate damages, and is not entitled to any compensation.

Held (on appeal), for P. In Tennessee, the failure to mitigate damages is an affirmative defense. Therefore, the employer must prove both the availability of suitable and comparable substitute employment and a lack of reasonable diligence on the part of the employee to find such employment. Furthermore, ***"only the amount that the plaintiff would have earned*** in the exercise of reasonable due diligence is applied to reduce his contractual damages." Therefore, the trial judge would have been correct in ruling, as he did, that P's recovery was completely eliminated (rather than merely reduced) "only if the proof show[ed] that the amount [P] would have earned in the exercise of reasonable diligence ***equaled or exceeded*** the amount he would have earned under the original employment agreement." Since the Ds presented no proof about the availability of comparable suitable substitute employment, the Ds were not entitled to *any reduction at all* under the duty-to-mitigate doctrine. *Maness v. Collins*, 2010 WL 4629614 (Tenn. Ct. App. 2010).

D. Sales contracts: The UCC sets forth certain rules regarding what an aggrieved buyer or seller must do to mitigate his damages.

1. Obligation of aggrieved buyer: If the seller delivers defective goods, or does not deliver at all, the buyer will probably be obligated to minimize his damages by taking the following actions:

a. Duty to "cover": If the seller either fails to deliver, or delivers defective goods which the buyer rejects, the buyer must usually attempt to ***"cover"*** for the goods if he wants to be eligible for consequential damages. That is, he must attempt to ***purchase substitute goods from another supplier***.

i. **How Code imposes this duty:** § 2-712(1) merely ***permits*** the buyer to cover; if he does so, § 2-712(2) gives him as a measure of damages the difference between the cost of cover and the contract price, as well as any consequential damages (see *infra*, p. 365). But § 2-715(2)(a), in defining "consequential damages" to include only those losses "which ***could not reasonably be prevented by cover*** or otherwise" in effect provides that the buyer ***must*** cover where he can reasonably do so, and may not recover for those damages (e.g., lost profits) which could have been prevented had he covered.

2. **Seller's duty to mitigate:** The ***seller*** of goods also has a *de facto* duty to mitigate damages. Where the buyer has wrongfully rejected goods, or has repudiated the contract before delivery, the seller has a choice of remedies. The Code does not expressly say that the seller has a duty to mitigate. However, the way the Code structures the seller's remedies means that a seller who does not attempt to mitigate may well bear the adverse consequences of not doing so.

   a. **Choice of remedies:** The seller has the following choice of remedies in the repudiation or non-acceptance scenario:

      i. **Resale:** The seller may choose to ***resell*** the goods (assuming that it's possible to identify which goods were the contracted-for ones), in which case the seller can recover the ***contract/resale differential.*** § 2-706(1). Resale is, of course, the conventional method of mitigating damages.

      ii. **Contract/market differential:** The seller may choose ***not*** to resell the goods. In that event, the seller normally recovers the difference between the ***contract price*** and the ***market price*** "at the ***time and place for tender.***" § 2-708(1). The problem for the seller is that if she doesn't resell, and the ***market price falls*** after the time when delivery was called for in the contract, the seller, not the buyer, will bear this loss. So in that sense, the ***seller will bear the risk of failing to mitigate*** by a resale.

      iii. **Contract price, where resale not feasible:** In some instances, the seller can hold onto the goods and sue for the ***contract price***. But the Code allows this only where "the seller is ***unable after reasonable effort to resell*** [the goods] at a reasonable price or the circumstances reasonably indicate that such effort will be unavailing." § 2-709(1)(b). This might be the case, for instance, if the goods were so highly customized (e.g., with the buyer's logo on them) that no other buyer would want them.

(1) **Can't sue for contract price:** So in the usual situation of resaleable goods, the seller is ***not*** free just to sit on the goods and sue for the purchase price. He must normally resell them, or else be content with the difference between the contract price and the market price at the time for delivery.

iv. **Lost profits:** If none of the above measures would protect the seller's expectation interest, he may recover ***lost profits*** from the transaction; see *infra*, p. 369.

b. Procedures for sale: If the buyer does plan to resell the goods he may do so either at a ***public sale*** (typically, an auction) or a ***private*** sale. § 2-706(2). But if the resale is to be private, the seller must give the buyer reasonable ***advance notice*** of the seller's intent to resell. § 2-706(3).

E. Affirmative conduct by plaintiff which increases loss: The situations which we have discussed so far are those in which the plaintiff has failed to make reasonable affirmative efforts to decrease the loss. In other cases, however, the plaintiff may increase his loss not by failing to act, but by ***acting affirmatively***. The rule here is the same: the aggrieved party may not recover for any damages which were caused by his own actions, and which he could have avoided by ***reasonably*** refraining from acting.

> **Example:** Farmer buys seed from D Manufacturing Company, which Farmer discovers to be defective before he plants it. He nonetheless makes an unreasonable judgment that things might turn out all right anyway, and goes ahead and plants it. If Farmer's crop fails, he cannot recover from D the value of a normal crop. His recovery will be limited to the price paid for the worthless seed.

F. Non-exclusive contracts: In the ordinary master-servant relationship, an employee who is wrongfully discharged is expected to seek other employment to mitigate damages. But if the employee (or independent contractor) had a ***non-exclusive*** relationship with the breaching party, so that the former was free to contract and work for others at the same time as for the breaching party, the gains which the aggrieved party made, or could have made, on other contracts after the breach are ***not subtracted*** from the plaintiff's recovery. The plaintiff would have been able to obtain these gains even if the defendant had not breached; they are therefore treated as independent of the breach, and do not affect the plaintiff's recovery.

> **Example:** P contracts to do computer programming for D. The contract contemplates that P will work as an independent contractor, and that the work will take approximately 100 hours, spread over a period of several months. The contract does not place any limits on P's right to do programming for other clients. Assume that even with the P-D contracts, P has more work-hours available than she is able to sell to clients. D breaches, and P sues for the profits which she would have made had D carried out the contract.
>
> Since P had both the right and the ability to contract with others in addition to D, D will not be able to claim that P could have mitigated damages by contracting with some other party for the services which she was going to provide for D. P may therefore recover full expectation damages.

1. **Sale of goods:** The "non-exclusive contracts" exception to the duty-to-mitigate rule is often applicable in sales of goods, particularly by a ***middleman***. The middleman can resell the goods that the defendant contracted for to someone else; however, if the middleman has a ***greater supply*** of them than his customers demand, he has not been made whole when he resells, since he will end up with ***one lost sale*** anyway. Such sellers, often called "lost volume" sellers, are discussed more fully *infra*, p. 369. See Rest. 2d, § 347, Comment f.

G. Losses incurred in avoiding damages: If the aggrieved party tries to mitigate his damages, and ***incurs losses or expenses in doing so***, he may ***recover*** damages for these losses. The expenditures must, however, have been reasonably incurred, and the damages which plaintiff is trying to mitigate must be the foreseeable result of the defendant's breach. It ***does not matter*** whether the plaintiff's attempt to mitigate damages is ***successful*** or not.

> **Example:** *A*, a shipping company, contracts with *B* for *A* to deliver goods to New York in time to comply with the terms of a contract between *B* and *C*. The terms of this contract are known to *A* when he agrees to make the shipment, but he delays delivery past the contract deadline. In a reasonable effort to save the contract, *B* travels to New York to meet with *C*. *C* refuses to extend the deadline and *B* loses the contract. *B* may recover, in addition to the lost profits, the costs of the trip. See

Rest. 1st, § 336, Illustr. 14.

Quiz Yourself on
FORESEEABILITY AND AVOIDABLE DAMAGES

97. The Three Little Pigs Cement Co. ("TLP") needs its main cement mixer to be taken back to the manufacturer for repairs. TLP calls the B. B. Wolf Transport Co. ("Wolf") and says, "How much would you charge to send a pair of drivers to drive our cement mixer to the manufacturer?" Wolf quotes a price of $500. TLP agrees, and says nothing else to Wolf. Wolf delivers the mixer to the wrong address, and it takes five days for the mistake to be tracked down. As a result, TLP must close down for those days, resulting in TLP's having $100,000 less of profits than had the delivery been done properly.

    (A) Can TLP recover the $100,000 losses from Wolf?

    (B) Now, assume that the day after the parties entered into the shipping deal and before the mixer was delivered anywhere, TLP called Wolf and said, "By the way, be extra careful to get the mixer to the right place at the right time, because we can't operate without it and every day until it's fixed, we lose about $20,000." Wolf mis-delivers the mixer anyway, with the same results as in part (A). May TLP recover its $100,000 losses from Wolf?

98. Anna Passemova is a prima ballerina for the 2 Left Feet Dance Company, a major company located in (and performing exclusively in) New York City. She has a three-year employment contract at $100,000 per year. Two years into the contract she is wrongfully dismissed.

    (A) For this part only, assume that Passemova sits at home for the remaining year, eating cheese puffs and watching soap operas. If Passemova had notified her agent that she was again available to dance, there is a better-than-50% chance that Passemova would have secured comparable roles paying her at least $40,000 during the remaining year of the contract. At the end of the year, Passemova sues 2 Left Feet for $100,000, the amount she would have earned had 2 Left Feet honored the contract. Will Passemova's recovery be reduced by $40,000?

(B) For this part only, assume that Passemova, acting promptly after the firing, notifies her agent that she is again available. The only offer that comes in is from a major San Francisco opera company, offering a two-month guest engagement paying $15,000. Passemova declines the offer, preferring to stay in New York City where she can be near her two small children. Will the $15,000 that Passemova could have earned from San Francisco be deducted from her recovery against 2 Left Feet?

99. The puppetmaker Geppetto hires Jiminy Cricket to be a full-time tutor to teach Geppetto's puppet, five-year-old Pinocchio, how to speak and write English. The contract is for one year, at $3,000 per month, and may not be terminated by Geppetto except for cause. After Cricket has been on the job for five months with adequate performance, Geppetto, acting without cause, fires him in a drunken rage. At the end of what would have been the year of employment, Cricket sues Geppetto for breach, seeking $3,000 times the seven months post-firing. At the ensuing bench trial, Geppetto offers testimony that English teachers qualified to teach five-year-old puppets usually earn about $2,000 per month in that locality. Geppetto also shows, without contradiction from Cricket, that following the firing Cricket sat at home all day for the next seven months singing songs, made no effort to find replacement employment, and earned no income. Neither side offers any evidence about whether any particular jobs teaching English to five-year-old puppets were available locally during the seven-month period at issue, or about whether Cricket's credentials would have been sufficient to obtain any such job if there one had been open. How much, if anything, should the judge award Cricket in damages?

100. Scarlett owns a saw mill. Cal Carpetbagger contracts to deliver 40 tons of pine logs to the saw mill, at a total cost of $20,000, payable cash on delivery.

(A) For this part, assume that Carpetbagger fails to deliver the logs as promised. Scarlett could procure comparable logs on short notice from an alternative source for $30,000, in which case she could keep the mill running without interruption. However, the other supplier would require that the logs be paid for in cash. Because Scarlett's business has been poor, and because she was budgeting just the $20,000 that was to be charged by Cal, Scarlett does not want to (though she could) lay out the

$30,000 the new supplier demands. Scarlett therefore instead closes down the mill for a week, until she can procure supplies priced at the same $20,000 as in the deal with Cal. Closing down the mill for the week results in $15,000 of losses to Scarlett. How much, if anything, may Scarlett recover from Cal?

(B) For this part, assume that Cal is willing and able to deliver, but that before he can do so, Scarlett wrongfully repudiates. On the day for delivery, the 40 tons have a market value of $20,000. These logs, like all the logs that Cal sells, come from his own land (he sells all the logs from his land as they mature). Cal could sell the 40 tons earmarked for Scarlett on the day she repudiates, but Cal holds on to them, thinking the market price will rise. Instead, the price falls, and Cal continues to refuse to sell. He still owns the logs when he sues Scarlett for breach. At the time of trial, the logs are worth $9,000. How much may Cal recover from Scarlett? (Ignore storage and other incidental costs caused by the breach.)

Answers

97. (A) No, because the lost profits were not reasonably foreseeable. In order to recover consequential damages (i.e., damages resulting as a consequence of the breach), the plaintiff has to show either that a ***reasonable person*** in the defendant's position would have foreseen the damages as a ***logical and ordinary result*** of a breach, or that the defendant had ***actual notice*** that this type of damage could occur. (This is the rule of *Hadley v. Baxendale*.)

Here, there's nothing to suggest that Wolf should have known that Three Little Pigs would have to shut down if the mixer was misdelivered: Temporary unavailability of a mixer wouldn't ordinarily cause this magnitude of losses (especially since a business that was so dependent on such machinery would ordinarily have a spare), so the loss wasn't reasonably foreseeable to one in Wolf's position. And the facts, by saying that TLP said nothing to Wolf except a description of the job and a request for a quote, show us that TLP didn't give Wolf actual notice of the danger of loss. As a result, the lost profits will be considered unforeseeable, and Wolf won't be liable for them.

(B) No. Foreseeability will be measured as of the time the contract was made. It is irrelevant that Wolf *subsequently* learned about the danger of extensive damages, even though it got this knowledge before it breached. (This makes sense, since Wolf had already quoted a price calculated based on the absence of any exposure to large business-interruption losses.)

98. **(A) Yes.** A party who suffers a breach of contract must make reasonable efforts to mitigate her damages. The duty to mitigate extends to employment contracts: wrongfully dismissed employees must look for comparable work (just as employers whose employees have wrongfully quit must look for comparable replacements).

(B) Probably not. It's true that a party must make reasonable efforts to mitigate damages. However, where the contract is for personal services, courts are quite lenient towards the plaintiff, and do not require her to accept any position that is substantially different from (even if not necessarily inferior to) the one contracted for. Here, the San Francisco position was much shorter than, and more importantly, 3,000 miles away from, the one Passemova had with 2 Left Feet. Especially considering Passemova's family reasons for not leaving New York for extended periods, it is very likely that a court would conclude that the San Francisco position was substantially different from the contracted-for one.

99. **$21,000, i.e., no deduction for failure to mitigate damages.** Courts generally view the so-called duty to mitigate as an affirmative defense, and therefore impose on the breaching party the ***burden of producing evidence*** that the non-breaching party / plaintiff failed to mitigate. In an employment case, this placement of the burden of proof usually means that it's not enough for the employer to show that the employee failed to act reasonably in seeking substitute employment. Instead, the employer must also: (1) ***identify one or more positions*** that the employee would likely have succeeded in obtaining, and (2) show ***how much*** the employee would likely have earned had she been offered and taken one of these suitable replacement positions. Here, Geppetto has made showing (2) (that a comparable position, if available, would have paid about $2,000 per month); but he has not satisfied (1) (i.e., he has not identified any particular comparable position that Cricket would likely have been able to obtain during the relevant time-frame). Therefore, the court will likely hold that Geppetto has failed to bear the burden of proving his failure-to-mitigate defense, and is not entitled to any reduction at all in damages. See *Maness v. Collins*, 2010 WL 4629614 (Tenn. Ct. App. 2010).

100. (A) $10,000, probably. A buyer of goods must make reasonable attempts to mitigate damages, just as most other types of victims of breach must do. It is likely that a court would conclude that Scarlett's unwillingness to come up with an extra $10,000 to avoid $15,000 in losses was unreasonable. If so, the court will limit her to the amount she would have lost had she reasonably mitigated (i.e., the $10,000 differential between Cal's price and the new supplier's price), not the $15,000 she actually lost.

(B) Nothing. When goods are resaleable and the seller does not choose to resell, his recovery is normally limited to the difference between the contract price and the market price on the day for delivery. § 2-708(1). (A "lost volume" seller can recover his lost profits under § 2-708(2) even if there is no contract-market differential, but the facts tell us that Cal is not a lost-volume seller, since he's already selling all the mature logs on his own land.) That differential is $0, which is all Cal can recover. The fact that the contract-market differential widened after the delivery date (to $11,000 by the time of trial) is irrelevant — Cal bears the risk of such a widening, giving him in effect a "duty to mitigate."

XI. NOMINAL AND PUNITIVE DAMAGES

A. Non-compensatory damages: The purpose of awarding damages in contract cases is normally to ***compensate*** the aggrieved party for economic losses caused and gains prevented by the breach. In some cases, however, compensation may not be appropriate because the plaintiff has not suffered any loss, cannot adequately prove any loss, or has suffered non-economic injury. An award of damages for something other than economic injury may be appropriate in such cases. Kinds of non-compensatory damages considered below are nominal damages, punitive damages, and damages for mental suffering.

B. Nominal damages: Where a right of action for breach exists, but no harm has been done or is provable, the plaintiff may get a judgment for

nominal damages. That is, he may recover a small sum that is fixed without regard to the amount of harm. See Rest. 2d, § 346(2).

C. Punitive damages: Punitive damages (sometimes called "exemplary" damages) are frequently awarded in ***tort*** cases, but rarely in the usual breach of contract case. Such damages, whose purpose is to punish and deter a wrongdoer, are considered inappropriate in contract cases, where breach is not viewed as a moral wrong.

1. Also a tort: Where, however, the breach of contract also ***constitutes a tort***, punitive damages *are* recoverable. Rest. 2d, § 355; C&P, p. 542.

a. Fraud: For instance, if the defendant commits ***fraud*** in inducing the plaintiff to enter the contract, punitive damages may be available.

Example: D, a car dealer, sells a used car to P. D states that the car is "nearly new," with only 3,000 miles on it. In reality, however, D has set back the odometer from 3,000 miles, and has steam-cleaned the engine to make it look new. P discovers D's misconduct a few months after the purchase, and sues. P will be entitled to punitive damages, since D's conduct — fraud — constitutes a tort as well as a breach of contract.

2. Bad faith as tort: Also, an increasing number of courts now regard a party's ***bad faith*** conduct in connection with a contract as *being* itself a tort, for which punitive damages may be awarded. In fact, if the court believes that the party ***breached voluntarily*** rather than involuntarily, and did so in an effort to ***make a better deal elsewhere***, the voluntary nature of the breach may by itself be enough to constitute bad faith punishable by punitive damages.

a. Insurance company bad faith refusal to settle: A very important aspect of bad faith breach involves ***insurance*** companies: if an insurer refuses in bad faith to ***settle a claim*** that is covered by a policy that it wrote, courts are especially likely to find that this refusal constitutes a tort punishable by the award of punitive damages. See Farnsworth, p. 789.

D. Damages for mental suffering: Damages for ***emotional disturbance*** as a result of breach of contract are recoverable only where the breach has also caused ***bodily harm***, or the contract or breach is "of such a kind that ***serious emotional disturbance*** is a ***particularly likely result.***" Rest. 2d,

§ 353.

> **Example:** *A*, a burial home, contracts to conduct a funeral service for *B*'s husband, and to supply a suitable casket and vault. Shortly after the husband is buried, *B* discovers that, because *A* has knowingly failed to provide a sufficiently water-tight vault, water has entered the vault and reinterment is necessary. *B* suffers mental anguish and illness as a result. If *B* sues for breach of contract, her damages will include compensation for her suffering, because contracts for burial services are of a sort which are particularly likely to result in emotional disturbance if there is a breach. Rest. 2d, § 353, Illustr. 3.

XII. LIQUIDATED DAMAGES

A. Reason for liquidated damages clauses: Parties negotiating a contract often make an explicit agreement as to what each party's remedy for breach of the contract shall be. The parties to a sales contract may, for instance, agree that if the seller breaches by failing to deliver, the seller shall pay the buyer damages of $100, and that if the buyer fails to make all payments, the seller may repossess the goods and keep whatever payments the buyer has already made. Such an agreement as to the consequences of breach, placed in the contract itself, is called a ***liquidated damages provision***.

B. Rules of enforceability: Such liquidated damages clauses, where enforced by the court, determine the measure of damages which the court will award. In order to be enforceable, however, the liquidated damage clause must always meet ***one*** (and in some courts, ***both***) of these two requirements:

[1] **Reasonable forecast:** The amount fixed must be ***reasonable*** relative to the anticipated or actual loss from breach (all courts require this); and

[2] **Difficult calculation:** In some courts, the harm caused by the breach must be ***uncertain or very difficult to calculate accurately***, even after the fact.

See Rest. 2d, § 356(1); C&P, p. 589.

C. Policy against penalties: These two requirements reflect a long-standing judicial policy against the enforcement of ***penalties*** for breach of contract. The purpose of damages is to put the plaintiff in the same position he would have been in had the contract been fulfilled, not a better one. Where a provision that is labeled a "liquidated damages" clause really serves to penalize a party for breach in an amount far beyond the loss suffered by the plaintiff, the courts simply refuse to enforce the provision, and award ordinary damages.

1. **Intent irrelevant:** If the amount stipulated in the liquidated damages clause is unreasonable, it is irrelevant that the parties subjectively attempted to provide for liquidated damages rather than a penalty. Nor does the fact that the contract refers to the clause as "liquidated damages" rather than as a "penalty" save the clause in this situation.

D. **Reasonableness of amount:** All courts agree that a liquidated damages clause will be upheld, rather than being struck down as a penalty, only if it provides for a ***"reasonable"*** amount.

1. **Time for measuring reasonableness:** There is dispute as to the ***time*** for ascertaining the reasonableness of the amount: is the issue whether the amount was a reasonable one *as of the time of contracting* (i.e., a reasonable forecast of likely damages from breach)?, or is it whether the amount is reasonable when viewed *as of the time of breach or trial* (i.e., reasonable compared with the ***actual*** damages)?

   a. **Traditional view:** The traditional view has been that the reasonableness of the clause is to be viewed ***solely as of the time of contracting***. This traditional view has two consequences:

   □ First, if the clause is a ***reasonable forecast*** viewed as of this time, the clause will be ***enforceable*** even though it turns out that the plaintiff has actually suffered much less damage than the liquidated amount.

   □ Secondly, if the clause sets an amount which is, viewed as of the time of contracting, unreasonably large, the clause ***will not be saved*** by the fact that plaintiff's actual damages have fortuitously turned out to be extraordinarily large.

   b. **The modern view:** The ***modern*** view, as exemplified by both the Second Restatement and the UCC, is that the clause should be enforced if it is the case that ***either:***

   [1] the clause is a ***reasonable forecast*** when viewed as of the time of contracting ***or***

   [2] the clause is reasonable in light of the ***actual*** damages

which have occurred.

See Rest. 2d, § 356(1). This modern view has two main consequences:

i. **Damages smaller than expected:** First, if the forecast is reasonable (viewed as of the time of contracting), the clause will be enforced ***even though it turns out that the plaintiff's damages are actually much less than might have been expected.*** (This result is the same as would be reached under the traditional rule.)

ii. **Unexpectedly high damages:** Secondly, a clause which is an ***unreasonable forecast*** (viewed as of the time of contracting) can nonetheless be ***saved*** if it turns out that the plaintiff's damages are unexpectedly high, and therefore in line with the clause. (This result is ***contrary*** to what would happen under the traditional rule.)

2. **No loss at all:** Suppose that the contract contains a liquidated damages clause, but the plaintiff sustains ***no actual loss at all***. Assuming that the clause is a reasonable estimate viewed as of the time of contracting, both the traditional and modern rules would, if followed with strict logic, result in the ***enforcement*** of the clause in this situation. Some courts have indeed enforced the clause in this context.

   a. **Restatement view:** However, many other courts, and the Second Restatement, deviate from strict logic when it comes to this situation of no actual loss. These authorities will ***not enforce*** the liquidated damages clause if it turns out that ***no actual damage*** has been sustained. See Rest. 2d, § 356, Comment b and Illustr. 4. This approach has been criticized as resulting in a "somewhat arbitrary distinction between situations in which there is no loss at all and those in which there is only a little loss." Farnsworth, p. 845.

3. **Damage computation keyed to gross revenues or the like:** Where the damages clause is keyed to the plaintiff's lost ***gross revenues***, lost ***gross profit***s, or other financial figure that is ***not necessarily tied to actual lost profits***, the court is likely to view the clause skeptically as being a ***poor estimate*** of actual losses, and thus unenforceable if it deviates materially from the actual losses.

Example: P, who operates a retail store, rents the store's premises from D, a municipality, under a 30-year lease. The lease provides that if D cancels the lease, D will pay P as damages an amount equal to 25% of P's average annual gross receipts for the three years preceding the breach. D cancels the lease after 17 years. P sues for enforcement of the liquidated damages provision, which would produce a recovery of $290,000.

Held, the case must be remanded for a factual determination of the reasonableness of the clause. "[D]amages based on gross receipts run the risk of being found unreasonable. Generally speaking, gross receipts do not reflect actual losses incurred because of the cancellation." Here, for instance, P's tax returns for the prior three years showed that the business never had a taxable profit of greater than $3,700, a far cry from the $290,000 amount the clause would generate. *Wasserman's Inc. v. Township of Middletown*, 645 A.2d 100 (N.J. 1994).

4. **Single damage amount regardless of severity of breach ("blunderbuss"):** Some liquidated damages clauses stipulate a ***single sum of money***, regardless of the extent to which the breach damages the plaintiff. For instance, the clause might contain a single damage formula for the breach of any covenant, whether a trivial or important one; such a clause is sometimes called a ***"shotgun"*** or ***"blunderbuss"*** clause. See Farnsworth, p. 943. Courts tend to be very skeptical of damage formulas that are ***"invariant to the gravity of the breach."*** *Lake River Corp. v. Carborundum Co.*, 769 F.2d 1284 (7th Cir. 1985).

   a. **Actual damage is trivial:** Where the actual damage turns out to be ***trivial***, most courts will not enforce a blunderbuss clause (or will interpret the clause as not applying to trivial breaches).

   Example: Contractor contracts to renovate Owner's office building by June 1, to get it ready for occupancy by Tenant beginning on August 1. The contract provides that if Contractor is late in completing work, he will forfeit $100,000, whether the delay is one day or 90 days. In the actual event, Contractor is two days late, and Owner deducts the full $100,000.

   Since the clause produces the same damage amount regardless of how much actual damage is sustained by Owner (a one-day delay wouldn't prevent Tenant's on-time occupancy, but a 70-day delay would), and since the actual damage has turned out to be trivial, the clause will be struck down as a blunderbuss clause.

   b. **Non-compete covenants:** This "no enforcement of blunderbuss clauses" rule is often applied to ***non-compete*** clauses. If the non-compete calls for the ***same fixed amount*** of damages ***regardless of the severity*** of the violation, that fixed amount will ***not*** be recoverable, and instead the plaintiff will be limited to those damages she can actually prove.

Example: A group of four pediatricians located in midtown Manhattan stipulates in their partnership agreement that if any one of them leaves the practice, he will not render care in Manhattan to an existing patient of the group for a period of one year following his departure. The agreement also states that "Because of the difficulty of proving damages from breach" of the one-year provision, a flat $50,000 in damages will be recoverable by the group for any breach. Each of the pediatricians earns about $90,000 annually. D then leaves the group, and 11 months later, furnishes services worth $50 to a teenager who is a patient of the group. The partnership sues D for $50,000.

The partnership will *not* be entitled to recover the liquidated damage amount of $50,000 from D. That's because the clause purports to impose the same recovery regardless of the severity of the breach — a former member who treats one patient one time one month before the non-compete is to expire is handled the same way as one who "steals" half the group's practice over the full twelve months. Since the blunderbuss clause is unenforceable, only the actual damages the group has suffered from the one patient treated by D (probably $50) can be recovered.

5. **Major loss:** But if the breach turns out to be a ***major*** one (so that the liquidated amount is reasonable in light of the actual loss), courts are split on whether the blunderbuss should be enforced. The prevailing modern approach is to ***enforce*** the blunderbuss where the actual loss is roughly equal to the damages provided in the clause.

E. **Difficulty of fixing damages:** In addition to the "reasonableness" of the amount (discussed above), most courts also take into account the ***difficulty*** in ***estimating*** or ***proving*** actual damages. Some cases, especially older ones, claim that it is an absolute prerequisite to the enforceability of a liquidated damages clause that it be difficult to prove that loss has occurred or to show its amount with the requisite certainty (see *supra*, p. 323).

1. **Modern view:** But the modern view, illustrated by the Second Restatement, is that the difficulty of proving loss is merely a ***factor***, along with reasonableness. As Rest. 2d, § 356, Comment b puts it, "If the ***difficulty of proof of loss is great***, ***considerable latitude*** is allowed in the ***approximation*** of anticipated or actual harm. If, on the other hand, the difficulty of proof of loss is slight, less latitude is allowed in that approximation."

F. **Damage clause limiting probable recovery:** The discussion above has focused on those liquidated damages clauses which threaten to be penalties, i.e., which provide for sums ***greater*** than the actual loss caused by the breach. In some situations, however, the liquidated damages clause may operate to the ***defendant's*** benefit, as a ***limitation on liability.*** The courts are in disagreement about when such a contractual limitation of liability is effective. But such liability limitations are rarely struck down on liquidated-damages principles.

> **Example:** Suppose that D, a security company, agrees to install a system on P's premises that will detect fires and burglaries, and report these by telephone to the police. The contract provides that if D shall be found liable for breach of the contract, D's liability "shall be limited to a sum equal to 10% of the annual service charge or $250, whichever is the greater." The system fails to operate properly, and P's premises burn down, at a cost to him of $50,000. P sues for breach of contract, and D asserts that the contractual limitation should be enforced.
>
> On these facts, courts are split both as to analysis and result. Some courts would treat this as a liquidated damages provision, in which case they might either enforce it as a reasonable estimate of damages, or refuse to enforce it on the grounds that it is not a reasonable estimate. Other courts reason that such a clause is not really a liquidated damages provision at all, but rather, an attempt to limit liability; they then tend to uphold it unless they find it unconscionable (see *infra*, p. 361), which they usually do not find it to be. Probably most courts, regardless of which theory they use, will enforce such a liability in the alarm context.

1. **Chance to buy extra coverage:** Whenever the validity of a provision limiting liability to a stated amount (less than the likely actual damages) is at issue, courts tend to give great weight to whether the defendant offered the plaintiff ***extra coverage*** for an extra price: if the defendant did so, it has a much better chance of having the provision enforced.

   a. **Common carrier:** For instance, UCC § 7-309(2) allows a ***common carrier*** to contractually limit its liability if it makes additional liability available to the shipper for an additional charge. Thus the typical overnight-delivery-service contract, which limits damages to, say, $100, but sells "insurance" for several dollars per hundred dollars of extra coverage, would be enforced by almost every court, whether on a liquidated-damages theory or not.

G. UCC rules on liquidated damages: The UCC takes a more friendly view of liquidated damages clauses than do the traditional common-law rules. § 2-718(1) provides that "damages for breach by either party ***may be liquidated*** in the agreement but only at an amount which is ***reasonable*** in the light of the ***anticipated or actual harm*** caused by the breach, the ***difficulties of proof of loss***, and inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. A term fixing ***unreasonably large*** liquidated damages is ***void as a penalty.***"

1. **Alternative test:** This language gives the party seeking to enforce a liquidated damages clause ***two chances*** to prove that the stipulated sum is reasonable: the reasonableness of the sum may be measured:

   [1] as of the time the ***contract is made or***

   [2] ***after the breach***.

   (See the phrase, "reasonable in the light of the ***anticipated or actual harm*** caused by the breach…"). In this respect, the Code matches the Second Restatement, and makes liquidated damage provisions more easily enforceable than the common-law rule, which requires reasonableness as of the time of contracting.

2. **Unconscionability:** Even if a liquidated damages clause meets the standard of § 2-718(1), however, it may still be declared ***unconscionable*** under the general unconscionability provision of § 2-302 (*infra*, p. 478).

3. **Code's own liquidated damages provision:** Where the parties do not agree on a liquidated damages provision, the Code in effect supplies one with respect to a seller who justifiably withholds delivery of goods because of the buyer's breach. In such a situation, the seller may keep all payments made by the buyer up to $500 or 20% of the full contract price, whichever is less. (§ 2-718(2)(b) — see *supra*, p. 340.) In addition to this, the seller may recover actual damages for the breach beyond the amount that he is able to keep. If the contract contains a valid liquidated damages clause, the seller may keep the buyer's payments up to the amount of this clause. ??

4. **Limitation on consequential damages:** Particularly in cases of sales contracts drafted by merchant-sellers, the contract may contain a provision ***limiting the seller's liability.*** § 2-719(3) provides that "consequential damages ***may be limited or excluded*** unless the limitation or exclusion is ***unconscionable***." Most litigation involving this provision has arisen in the context of limitation of liability for breach of warranty, a subject which is discussed *infra*, p. 504.

H. Consequence of unenforceability: If the liquidated damages clause is struck down as a penalty, the plaintiff is not left without remedy. Instead, he merely reverts to his ***common-law damages***, usually expectation damages.

Quiz Yourself on
NOMINAL AND PUNITIVE DAMAGES; LIQUIDATED DAMAGES

101. Acme Generators has a contract with Sonja's Ice Sculptures, whereby Acme is to install a generator to ensure continuous operation of Sonja's freezers. It turns out that Acme's owner, Frosty Snowman, has a brother in the ice sculpture business. To help his brother, Frosty installs a faulty generator at Sonja's. The power to Sonja's freezers fails during a storm, the generator does not kick on, and her inventory of valuable ice sculptures melts. In her breach of contract suit against Acme, might she be awarded punitive damages?

102. The Bride of Frankenstein contracts with Miss Havisham to buy her used wedding gown for $150. Shortly before Bride's wedding date, Miss Havisham calls and says that she cannot part with her gown and that she refuses to go through with the contract. Bride immediately starts looking for a replacement dress. While out shopping, she runs into her friend Liz, who has been married eight times. Liz offers to sell Bride one of her used gowns for $150. Bride accepts with pleasure, knowing what impeccable taste Liz has. Bride then sues Miss Havisham for breach of contract. What damages will she be entitled to?

103. Ben Hur contracts with Athena contractors to construct a shopping mall, the Parthenon, on his property. To take advantage of the Christmas shopping season, the contract stipulates that the mall must be completed by November 1.

(A) For this part only, assume that the contract provides that if the mall is not done by November 1, Athena will be liable for a flat-fee liquidated damages amount of $100,000. (The amount does not change with the length of the delay.) Viewed as of the moment of contracting, the $100,000 is a good estimate of the damages likely to be caused by a delay of between 1-2 weeks, but is not a good estimate of damages from a delay of less than 1 week, or more than 2 weeks. In reality, the mall opens on November 8. If Ben Hur presents evidence that his actual damages from the delay are $80,000, how much will the court award?

(B) For this part, assume the same facts, except that the delay is 2 days, and Athena shows at trial that Ben's damages are only $20,000. How much will the court award?

(C) Assume instead that the contract states as follows: For every calendar day completion is delayed by Athena, Athena will pay $10,000 in liquidated damages, which is what Ben reasonably anticipates earning in gross profit on a daily basis. Athena slips behind schedule and the mall is not complete until November 15. Ben's actual damages turn out to be $75,000. How much may Ben recover?

Answers

101. Yes. Frosty clearly acted in bad faith here by purposely installing a faulty generator. Although punitive damages are not normally granted in contract actions, an increasing number of courts now regard a party's extreme bad faith conduct in connection with a contract as being itself a tort, for which punitive damages may be awarded. Conduct that occurs within the context of a contractual relationship, but that is motivated by the defendant's improper desire to harm the plaintiff, is the sort of extreme bad faith that can properly be punished by a punitive-damage award.

102. Nominal damages only. Since Bride was able to mitigate her actual damages completely through her cover contract with Liz, she has no economic harm that requires redress. Nonetheless, the court will award Bride nominal damages (probably $100 or less) as a way of acknowledging that she was wronged when Miss Havisham breached their contract.

103. (A) Probably $100,000. A liquidated damages clause will be struck down (under the modern approach) unless it meets either of two tests: (1) it is a reasonable forecast viewed as of the time of contracting; or (2) it is a reasonable estimate, viewed after-the-fact. Here, the clause amount satisfies (2), since it is reasonably close to the actual loss. Therefore, the court will probably uphold the award.

Table 10-1

ISSUES CHECKLIST: Main Issues in Remedies

Note: This Table does not deal specifically with Remedies in Sales Contracts.

Issue	Rule or Recommendation	Examples / Notes
[1] Is ***legal*** relief ***inadequate***?	If yes, award ***equitable relief*** (***injunction*** or order of ***specific performance***).	**Example 1 (specific performance):** D contracts to sell P a parcel of land. D refuses to convey. P can get order of specific performance, since each parcel is deemed unique. **Example 2 (injunction):** D sells a business to P and agrees not to compete within 1 mile for 1 year. In 6 months, D starts competing. P can get injunction prohibiting D from competing for the rest of the year.
[2] Has P proved expectation damages with ***reasonable certainty***?	If no, award ***restitution*** or ***reliance***.	**Example**: D (a bank) contracts to lend P (a builder) $400K to build a house, which P hopes to sell for a $100K profit. After P has spent $20,000 preparing to build the house, D breaches. If P can't show with reasonable certainty what his profit would have been, the court should award $20,000 (his reliance damages).
[3] Has P breached, but ***substantially performed*** (i.e., any breach was not "material")?	If yes, award P ***expectation*** damages, subject to ***counterclaim*** for D's damages from the non-material breach.	**Example**: P (a builder) contracts to build a house for D on D's land, for $300K. The contract specifies a 15x25 ft. master bedroom. Inadvertently, P builds the house so that the master is 6 inches too narrow. The fair value of the house as built is $250K; if it had been built exactly to spec, its value would have been $255K. Since P has substantially performed, P can recover $300K (the contract price) less $5K (the lost value from the breach). P is not limited to the fair value of his work (the $250K figure). E VII(B). (But see item [4] below for the "willful breach" problem.)
[4] If this is a construction contract where D (contractor) has breached, will giving P (owner) cost-of-repair damages ***encourage waste?***	If yes, award ***change-in-value*** damages instead of cost-of-repair.	**Example:** Same facts as Example in [3]. Assume it would cost $100K to rebuild the master bedroom to add the 6 inches. The court will deduct the loss in value ($5K), not the cost of repair ($100K), to avoid economic waste. (However, if D's breach was "willful," i.e., intentional, the court might award the $100K.)
[5] Has P breached and not "substantially performed," but done ***some meaningful work*** on the contract?	If yes, award P ***restitution*** damages, limited by the ***pro-rata contract price***. *Note:* However, in some jurisdictions, if P's default was "***willful***" (e.g., he walked off the job to take a higher-paying contract), P may not be allowed to recover even restitution.	**Example:** P contracts to build a house for D for $300K. When the work is 1/2 done, P walks off the job without cause. The value of the uncompleted house is $100K. Since P has not substantially performed, he cannot recover "on the contract" (even with a deduction for D's damages from non-completion. However, P can recover the ***value to D*** of the work done ($100K), but only to the extent that this does not exceed the pro-rata contract price ($150K). (But see Note at left about "willful" breach.)

Issue	Rule or Recommendation	Examples / Notes
[6] Assuming D breached, is some portion of P's damages due to a loss item that was neither ***"naturally occuring"*** nor due to special circumstances of which D was ***aware***?	If yes, D cannot recover these special damages, under the rule of *Hadley v. Baxendale*.	**Example**: D contracts to fix P's broken drill-press for $1K, the work to be finished in 7 days. D breaches by taking 20 days. P's entire factory is out of business for the extra 13 days, costing P $100K in lost profits. Unless D knew that the delay would cause the factory to shut at enormous loss, P can't recover the $100K.
[7] Assuming D breached, is P seeking items of loss that P could reasonably have ***avoided*** (e.g., by finding an alternative supplier)?	If yes, P cannot recover these "avoidable damages." P is said to have failed in his ***"duty to mitigate."***	**Example**: D contracts to sell P 1,000 widgets at $2 apiece, delivery due 6/1. D fails to deliver on 6/1. P could procure the items from an alternative supplier for $3. P unreasonably delays in doing so until 9/1, when the price is now $5, at which point P covers. P can recover $1 per item, but not $3 (since the final $2 was due to P's unreasonable delay in covering).
[8] Does the contract include a formula or fixed sum as agreed-upon damages if D breaches ("***liquidated damages***")?	If yes, P cannot recover the agreed-upon sum unless it was either: (1) a ***reasonable forecast*** of the loss, as of the time of the contract; or (2) reasonably close to the damages ***actually suffered*** by P. A clause that doesn't meet either of these tests is an unenforceable "***penalty***." *Note:* A penalty is likely to be found where the same amount is assessed regardless of the severity of the breach (as in the Example at right).	**Example**: In a construction contract with Owner, Builder agrees to have deducted from the $300K contract price $75K for a delay, whether the delay is 1 day or 30 days. At the time of the contract, it's clear that Owner will suffer no damages from a delay of less than 10 days, but large damages for any delay longer than that. Builder is 2 days late. The court will not allow Owner to deduct the $75K, because this figure was neither a reasonable estimate of loss as of the time of contract, nor reasonably close to Owner's actual damages ($0). (This type of clause, assessing the same amount of liquidated damages regardless of the severity of the breach, is called a ***"blunderbuss"*** clause, and will rarely be enforceable unless it happens to produce an estimate that turns out to be close to the actual damage.)

(B) Probably $20,000. As we explain in the answer to part (A), a liquidated damages clause will be valid if it's a reasonable estimate of likely damages, viewed as of the moment of the contract, even if the estimate turns out to be quite badly off. However, a ***"blunderbuss"*** clause that assigns the same damage award regardless of the severity of the default will generally not be considered a reasonable advance estimate, considering the variation in scenarios (and damage amounts) that the clause will cover. The clause here, which is invariant to the length of delay, would probably be considered a blunderbuss clause. Even a blunderbuss clause will be saved if it turns out to be reasonably accurate. But the estimate of $100,000 is not reasonably close to the $20,000 actual delay, so there is no after-the-fact accuracy to save the clause. Consequently, the court will probably strike it down, and award just the actual damages suffered by Ben.

(C) $150,000, i.e., the amount called for by the clause. As noted in the prior parts, a damages clause will be valid if it's a reasonable forecast viewed as of the moment of contracting, even if the estimate turns out to be quite inaccurate. That's what happened here: keying damages to the number of days of delay, multiplied by a reasonable estimate of each day's damages, is certainly a reasonable method of forecasting loss. Therefore, the clause won't be rendered invalid by the fact that the actual damages turned out to be much less than the forecasted ones. (Note that the per-day calculation method is what prevents this from being a "blunderbuss" clause like the one in parts (A) and (B).)

XIII. DAMAGES IN SALES CONTRACTS

A. Distinction between acceptance and rejection: The UCC gives a variety of remedies to the seller or buyer who is injured by a breach of contract. In analyzing these remedies, it is important to distinguish between those situations in which the buyer has ***accepted*** defective goods (and never revoked his acceptance) and those in which the buyer has either rejected the goods (rightfully or wrongfully) or revoked his acceptance of them, or failed to receive delivery from the seller at all. We shall first consider the latter group of situations (rejection, revocation, or failure to deliver) in which the buyer does not end up with the goods on hand.

B. Buyer's damages generally, where goods have not been accepted: If the seller ***fails to deliver*** the goods at all, or delivers ***defective goods*** which the buyer rightfully ***rejects*** (or accepts but then revokes his acceptance), the buyer has a ***choice*** of remedies:

□ The most important of these is his right to ***"cover,"*** i.e., to buy the goods from another seller, and to recover the ***difference between the contract price and the cover price*** .

□ If he decides not to purchase the goods elsewhere, he can recover the traditional contract measure of damages, i.e., ***the difference between the contract price and the market price at the time of breach***.

□ Thirdly, in a few situations he may obtain a decree ordering ***specific performance*** of the contract.

No matter which of these three remedies he obtains, the buyer may also recover ***"incidental" and "consequential" damages*** stemming from the breach.

> **Note:** For our discussion of buyer's damages where the buyer ***accepts*** the goods (and never revokes the acceptance), see *infra*, p. 373.

1. Right of cover: Where the seller does not deliver, or delivers defective goods which the buyer rejects, the buyer will normally want to ***purchase substitute goods, or "cover."*** If she does so, she can recover her extra costs.

a. Code rule: This is accomplished by § 2-712(2): "The buyer may recover from the seller as damages ***the difference between the cost of cover and the contract price*** together with any incidental or consequential damages … but less expenses saved in consequence of the seller's breach."

b. Reasonableness of cover: The buyer's purchase of substitute goods must be "reasonable," and must be made "in good faith and without unreasonable delay." § 2-712(1).

2. Contract/market differential: In most instances, the buyer will cover. Occasionally, however, he may decide that he does not need the contracted-for goods after all, or is unable to find a reasonable substitute. Where the buyer ***does not cover,*** the Code gives him the traditional pre-Code measure of damages for sales contracts: the ***difference between the contract price and the market price*** "at the time when the buyer learned of the breach…" (§ 2-713(1)). In addition to this contract/market differential, the buyer may also recover any incidental and consequential damages arising from the breach, but expenses saved by virtue of the seller's breach are deducted from his recovery.

a. Expectation interest not protected: Observe that awarding the buyer the difference between the contract price and the market price at the time of breach does ***not*** necessarily protect his ***expectation interest***. The recovery awarded by the contract/market differential may be either greater or less than the expectation measure, and will equal it only by coincidence.

i. **Buyer who has fixed resale contract:** The problem that the contract/market differential may not correctly compensate the buyer is especially acute where the market is rising and the buyer has ***already made a fixed-price or fixed-margin contract to resell*** the goods. If the market-price increase times the quantity is greater than the profit margin on the buyer's resale contract, giving the buyer the contract/market differential will put the buyer in a ***better position*** than she would have been in had the contract been fulfilled.

(1) **Minority view:** A ***minority*** of courts has therefore concluded that the contract/market differential in this buyer-has-already-contracted-to-resell situation should be ***limited to the profit that the buyer would have made*** on the completed transaction had there been no breach, at least where the resale contract is written in such a way that the buyer's buyer can't sue the buyer for similar contract/market damages.

(2) **Majority view:** But ***most*** courts hold that the buyer is ***entitled to the full contract/market differential even where this would put her in a better position*** than had the contract been fulfilled, because limiting damages to the buyer's lost profits would ***incentivize the seller to breach.*** See, e.g., *Tongish v. Thomas*, 840 P.2d 471 (1992).

b. Contract/market differential not available to covering buyer: The buyer may recover the contract/market differential ***only where he did not cover***. See Comment 5 to § 2-713. ?

3. Consequential and incidental damages: Just as a buyer who covers may, in addition to the contract/cover differential, recover for "incidental" and "consequential" damages, so may the ***non-covering*** buyer recover incidental and consequential damages in addition to the contract/market differential.

a. Consequential damages: "Consequential" damages (defined in § 2-715(2)) include the ***profits which the buyer could have made by reselling*** the contracted-for goods, had they been delivered. For a more complete discussion of consequential damages, including the requirements that they be proved with appropriate certainty and that they be reasonably foreseeable, see *supra*, p. 343.

b. Incidental damages: Incidental damages are defined in § 2-715(1) to include expenses "reasonably incurred in ***inspection***, receipt, ***transportation and care*** and custody of goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with ***effecting cover*** and any other reasonable expense incident to the delay or other breach."

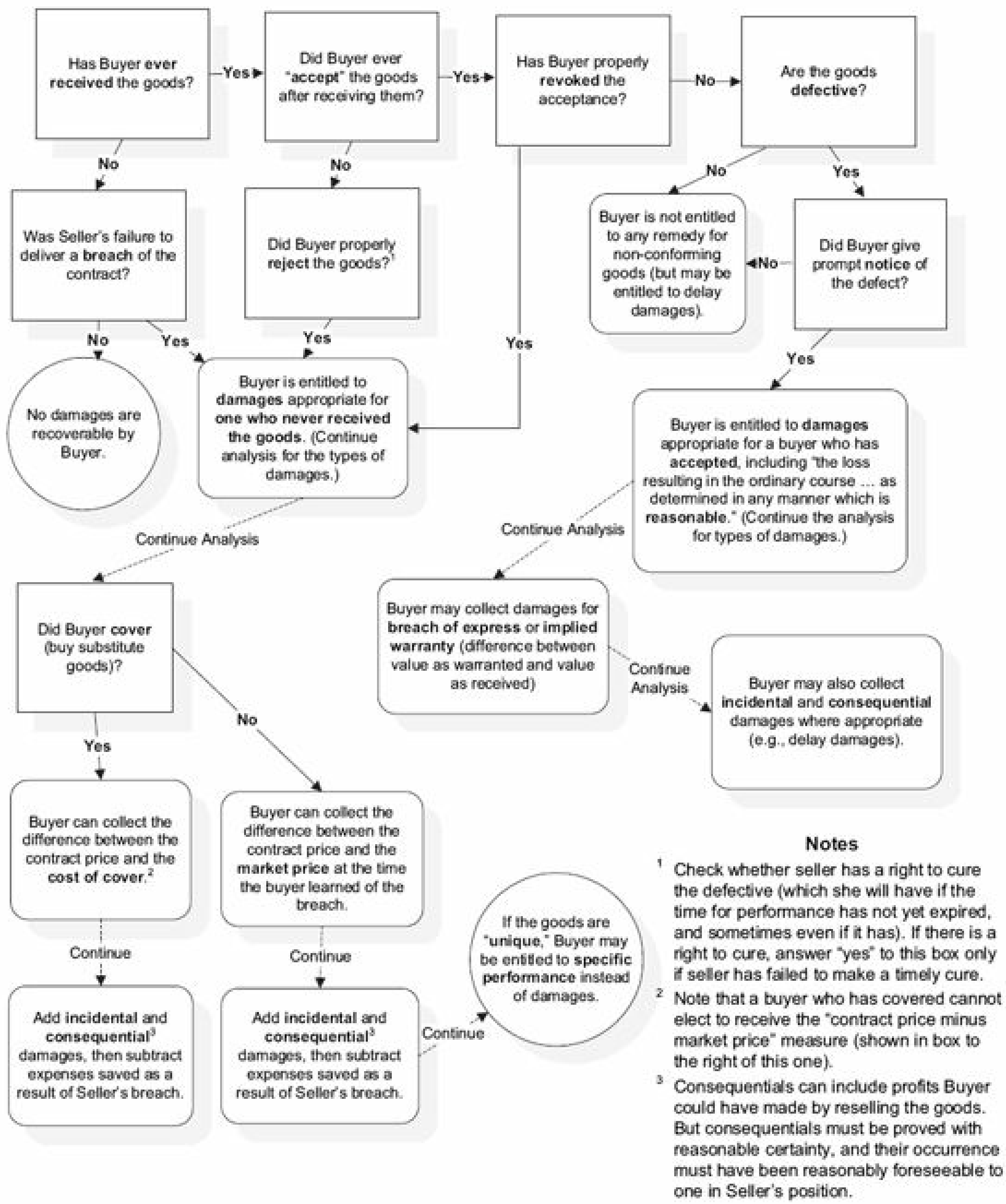
Example: Buyer rightfully revokes his acceptance of an airplane which Seller has misrepresented to be airworthy.

Held, Buyer may recover, among other damages, "incidental damages" for the expenses of storing the plane, oiling it, and insuring it. *Lanners v. Whitney*, 247 Ore. 223 (1969).

4. Specific performance: In a few situations, the buyer may obtain an order of specific performance, i.e., a court decree ordering the seller to supply the goods provided for in the contract. § 2-716(1) provides that specific performance may be decreed "where the goods are unique or in other proper circumstances." Specific performance in UCC cases is discussed more extensively *supra*, p. 316.

Figure 10-1

Buyer's Remedies under Sales Contract (UCC)



5. Rejection as a remedy: In addition to the above judicial remedies, the buyer to whom the seller delivers non-conforming goods has a crucial self-effectuating remedy, the right to ***reject the goods***. By exercising his right of rejection, the buyer can throw the goods back on the seller, thus cancelling the contract. See the discussion of rejection, *supra*, p. 231. In the usual case where the buyer, after rejecting the defective tender, covers (and possibly recovers the contract/cover differential), the right of rejection has simply enabled her to protect her expectation interests by approximating the position she would have been in had the contract been completed.

C. Seller's damages for breach: The Code provides an aggrieved ***seller*** with a choice of several damage measures:

- ☐ If the seller has ***resold*** the goods, he may recover the ***difference between the contract price and the resale price***. (See p. 368.)
- ☐ If the buyer wrongfully ***refuses to accept*** the goods (i.e., wrongfully ***rejects*** them), wrongfully ***revokes his acceptance*** of them, or ***repudiates*** the contract before shipment is even made (and the seller ***doesn't resell*** the goods), the seller may recover the ***difference between the contract price and the market price***. (See p. 365.)
- ☐ If neither of the above two just-listed measures (contract-market differential and contract-resale differential) is adequate to compensate the seller, he may be able to recover ***"lost profits."*** (See p. 369.)
- ☐ Where the goods have been ***accepted*** by the buyer, the seller may recover the ***contract price***. (See p. 371.)
- ☐ Lastly, even if the buyer never formally accepted the goods, the seller may in some situations (e.g., where the goods are unresaleable because custom-made) be able to recover the ***entire contract price***. (See p. 371.)

We consider each of these measures separately.

1. Resale by seller: Where the buyer rejects goods or repudiates before they are even shipped, the seller will normally ***resell them*** to a third party. If the resale is "made in good faith and in a commercially reasonable manner," the seller may recover "the ***difference*** between the ***resale price*** and the ***contract price*** together with any incidental damages…but less expenses saved in consequence of the buyer's breach." § 2-706(1). This measure will put the reselling seller in approximately the position he would have been in had the contract been performed by the buyer. (If the resale price is ***higher*** than the original contract price, the seller may keep the extra profit rather than turning it over to the original buyer.)

> **Example:** Seller contracts to sell Buyer 100 "truth rings," which will allegedly change color if the wearer lies. The total contract price is $200. Before shipment, Buyer wrongfully repudiates the contract. Seller resells the lot of 100 rings to X, who pays $100 for them. Assuming that the resale was made "in good faith" and "in a commercially reasonable manner," Seller may recover damages of $100 (the contract price minus the resale price) from Buyer. (If X pays $300, Seller may keep the $100 profit over the original contract price.)

a. **Public versus private sale:** The resale may be at either a ***public*** sale (i.e., an auction) or at a ***private*** one. Whether the sale was made publicly or privately, it must be made "in a commercially reasonable manner" and "in good faith." § 2-706(1)). The treatment of the two kinds of sale differs principally concerning the kind of notice that must be given to the breaching buyer:

   i. **Notice in private sale:** Where the seller plans to resell ***privately***, he is required only to give reasonable notice to the buyer that he intends to resell, and need not specify the time at which resale is to occur or anything else.

   ii. **Notice of public sale:** If the resale is to be ***public***, the seller must give the buyer "reasonable notice of the time and place of the resale," (§ 2-706(4)(b)), unless the goods are "perishable or threaten to decline in value speedily." The public sale must take place at a "usual place or market for public sale" if one is available. The seller may purchase at the public sale.

2. **Contract/market differential:** If the seller does ***not resell*** the goods, he may recover from the non-accepting or repudiating buyer "the ***difference*** between the ***market price*** at the time and place for tender and the ***unpaid contract price*** together with any incidental damages … but less expenses saved in consequence of the buyer's breach." § 2-708(1). Thus the seller who does not resell receives the traditional contract/market differential, just as does the buyer who does not cover.

   a. **Use by seller who has resold:** May a seller who has ***resold*** the goods recover the ***contract/market differential*** rather than the contract/resale differential? It's not clear. White & Summers conclude that the question is a close one, but recommend that the seller who has resold ***not*** be allowed to obtain the contract/market differential, since to allow him to do so would put him in a better position than he would have been in had the contract been fulfilled. (Obviously, the seller who has resold will only try to use the contract/market differential if it is greater than the contract/resale differential.) W&S, p. 261.

3. **Lost profits:** A seller who has resold may in some cases not be adequately compensated by the contract/resale differential. Similarly, the seller who has not resold may sometimes not be fully compensated by the contract/market differential. Another Code provision, § 2-708(2), lends relief to such sellers:

> "If the measure of damages provided in subsection (1) [the contract/market differential] is ***inadequate*** to ***put the seller in as good a position as performance would have done*** then the measure of damages is the ***profit*** (including ***reasonable overhead***) which the seller ***would have made from full performance*** by the buyer, together with any ***incidental*** damages…, due allowance for costs reasonably incurred and ***due credit for payments or proceeds*** of resale."

a. **Situations where this applies:** This ***"lost profits"*** section thus explicitly allows the court to grant the aggrieved seller expectation damages. There are two common kinds of situations in which the section will be applied:

i. **The "lost volume" seller:** Many sellers can make or acquire ***enough units*** of the item in question to sell to meet all foreseeable demand. Therefore, when the buyer from such a seller breaches his contract, and the seller resells the item to the substitute customer at the same price, the seller will end up making ***one fewer sale*** because of the breach. This is because the new customer would have bought a unit of the item anyway, regardless of whether the first customer had breached. The seller in this situation, frequently called a ***"lost volume"*** seller, will be able to use § 2-708(2) to recover the profit he has lost by reason of the breach.

Example: P, a manufacturer of medical X-ray machines, contracts to sell one of its RayGun 2000 machines to D, a hospital, for $300,000. D refuses to take delivery or to pay the balance due under the contract. P resells that particular machine to X for the same price at which it was to be sold to D. P then sues D, asserting that it is entitled to recover its “lost profits,” the difference between the $300,000 contract price and P’s marginal costs in producing the machine. D argues that P sold the machine to X for the contract price, so P has not suffered any loss.

If P can show that it had enough manufacturing capacity that it could have timely and profitably fulfilled the contract with X (and any other outstanding contracts it had for the RayGun 2000) while *also* fulfilling the one with P, P will win. If P makes such a showing, it will be treated as a “lost volume” seller — it made one fewer sale because of D’s breach. As a lost volume seller, P would not be adequately compensated by recovering merely the contract/resale differential (which, here, is $0). Therefore, P will be entitled to “the profit (including reasonable overhead) which the seller would have made from full performance by the buyer” (§ 2-708(2)).

(1) **Overhead as profit:** § 2-708(2) provides that the lost profits recovered by a seller suing under that section may include ***“reasonable overhead.”*** What this means is that the seller’s recovery is the contract price minus any ***variable*** costs associated with the particular item, but not minus the overhead costs (i.e., the fixed costs) which the seller would have incurred whether or not he had ever sold the item in question.

Thus in the above example, the profit which D has “lost” will be computed by taking the contract price, and subtracting D’s direct costs in producing the machine (e.g., cost of parts, cost of labor to assemble the parts, cost of testing, etc.), since those costs were incurred by D only in connection with the particular machine in question. But a pro rata amount for D’s rent, electricity, administrative expenses, etc., does ***not*** have to be subtracted, since these are items of overhead and D would have incurred those costs even if it had never sold the machine in question to anyone.

(2) **Available only where seller was not limited in supply:** The seller is a “lost volume” seller, and thus entitled to recover lost profits, only where he had ***as many units of the item available for sale as he could plausibly sell.*** If the demand for his product was greater than his supply, he has not lost anything by virtue of the breach, since with or without the breach he will end up selling the same number. (Also, some courts require the seller to show that he could have made a sale both to the buyer and to the resale buyer at a ***profit.***)

ii. **“Jobbers”:** Another group of sellers who will benefit from the “lost profits” remedy given by § 2-708(2) are usually called ***“jobbers.”*** A jobber is a ***middleman*** who as a matter of course does not purchase goods until he has already made a contract for their sale. Where a jobber finds a buyer for goods, who then repudiates the contract, the jobber never acquires the goods at all, and obviously does not resell them. The contract/market differential will not compensate an aggrieved jobber as long as the market price is close to the contract price. Yet such a jobber has, by virtue of his buyer’s breach, lost the chance to make a profit on the goods which he never acquired. Therefore, he will be able to obtain the profits he would have made by resorting to § 2-708(2).

4. **Seller’s action for the price:** Where one of the three seller’s remedies discussed above (contract/resale differential, contract/market differential, lost profits) is applied, the seller’s recovery will almost always be something less than the contract price. Either the seller will have resold the goods for some amount, or the goods will still have some market value at the time of breach, or under the “lost profits” formula the seller will be saved some direct costs because he does not have to perform. But in a few circumstances, the Code allows an aggrieved seller to sue for ***the entire contract price***. § 2-709 gives the seller such a right in three different circumstances:

- Where the goods have been ***“accepted”*** by the buyer;
- Where the goods have been ***lost or damaged*** within a reasonable time after the ***risk*** of their loss ***passed to the buyer***; or
- Where goods have been ***“identified to the contract,”*** and the seller is ***unable to resell them*** at a reasonable price.

Let’s take a look at each scenario.

a. **Accepted goods:** If the buyer has ***“accepted”*** the goods (acceptance is discussed *supra*, p. 231), it is reasonable to allow the seller to sue for the full contract price. § 2-709(1) does this: “When the buyer fails to pay the price as it becomes due the seller may recover, together with any incidental damages ... the ***price (a) of goods accepted[.]”***

The buyer may, however, have a counterclaim for damages if the goods didn't conform to the contract specs. (This right is discussed further below, in the discussion of buyer's and seller's remedies with respect to accepted goods; see *infra*, p. 373.)

b. Risk of loss has passed: The Code lays down several rules for determining when the ***risk of loss*** or damage to the goods passes from the seller to the buyer. These rules are discussed in the chapter on Impossibility, *infra*, p. 436. Once the risk of loss has passed to the buyer, the Code takes the position that the obligation to use or dispose of the goods is placed upon the buyer, and the seller should be able to recover the full contract price. § 2-709(1)(a).

c. Unresaleable goods: Where the seller has already ***earmarked*** particular goods as being the goods he will supply under the contract, and the buyer either rejects them or repudiates before delivery, the seller may recover the contract price if he is "unable after a reasonable effort to sell them at a reasonable price or the circumstances reasonably indicate that such effort will be unavailing." § 2-709(1)(b). This section deals with those situations in which the market price of the contract goods has dropped so sharply that there is virtually no market left, or where the goods are ***custom-made*** and therefore unresaleable.

Example: Seller contracts to custom-manufacture for Buyer, for a total price of $100,000, 10,000 book bags with Buyer's name and logo on them. After seller has sewn the 10,000 bags and has put Buyer's name and logo on 8,000 of them, Buyer wrongfully cancels the contract. Assume that there is no reasonable resale market for the bags (even the 2,000 that don't yet have a name/logo), because of their unusual design.

Seller will be entitled to recover the entire $100,000 contract price from Buyer, because "the circumstances reasonably indicate that [an] effort [to resell] will be unavailing."

5. Incidental damages: No matter which of the above remedies the seller pursues, he has a right to recover ***"incidental damages"*** suffered in connection with the breach. Under § 2-710, these incidental damages include "any commercially reasonable charges, expenses, or commissions incurred in stopping delivery, in the transportation, care and custody of goods after the buyer's breach, in connection with return or resale of the goods or otherwise resulting from the breach."

6. **No consequential damages:** Nearly all courts hold that the seller may ***not***, however, recover ***"consequential damages"*** from the breach. Such consequential damages are, as we have seen, always available to an aggrieved buyer; *supra*, p. 366. But nowhere in Article 2 is the seller explicitly given the right to receive consequential damages. The seller will seldom have any consequential damages from the breach anyway; since the only thing he was entitled to under the contract was the contract price, an award of this price, or some portion thereof, will normally fully compensate him. But examples can be imagined where the seller does suffer consequential losses (e.g., the breaching buyer is a "reference account" that the seller was counting on being able to point to with other prospective customers), and if he does, the general rule seems to be that he cannot recover them.

   a. **Contrary view:** But a few commentators and courts believe that a seller should be able to recover consequential damages even though the UCC nowhere explicitly awards them. Section 1-305(a) provides that consequential damages are not available unless they are expressly called for in the UCC "or by other rule of law." This minority believes that ***general common-law*** principles can and should be construed to make consequential damages available to all contracting parties, and that these common-law principles are "other rules of law," to be imported into the Code via § 1-103(b). See W&S, pp. 287-290.

7. **Liquidated damages:** The seller may also recover ***liquidated damages*** in some circumstances. If the contract has a valid liquidated damages clause, the seller may recover under that clause. See *supra*, p. 360. Even if the contract is silent about liquidated damages, the seller may be able to keep all or part of any ***deposit*** paid in advance by the buyer, as a kind of liquidated damages clause supplied by the UCC. (More precisely, the seller may keep $500 or 20% of the contract price, whichever is less, and must return the rest; see § 2-718(2), discussed further *supra*, p. 340.)

D. **Damages where the goods are accepted:** All of the remedies discussed above apply only where the buyer has never accepted the goods (or has revoked his acceptance). His non-acceptance may result from the seller's failure to deliver at all, the seller's delivery of a defective tender which the buyer rightfully rejects, the buyer's repudiation and the seller's consequent non-delivery, the buyer's wrongful rejection of the seller's conforming tender, etc. But if the buyer does accept the goods (and does not rightfully revoke his acceptance), a different set of Code remedies comes into play. In the seller's case, the action is one for the ***contract price***. In the buyer's case, the action is for ***breach of warranty***.

1. **Seller's action for price:** When the buyer accepts the goods, the seller may recover the ***full contract price*** under § 2-709(1)(a). This is so whether the buyer keeps the goods, resells them or otherwise disposes of them. However, if the goods are defective, the seller's action for the contract price will be subject to the buyer's right to counterclaim for breach of warranty, discussed immediately below.

2. **Claim of buyer who has accepted:** A buyer who has accepted goods which turn out to be defective may sue (or counterclaim) for breach of contract. In order to preserve his right to sue for breach, "the buyer must ***within a reasonable time*** after he ***discovers or should have discovered*** any breach ***notify*** the seller of breach or be ***barred*** from any remedy." (§ 2-607(3)(a).)

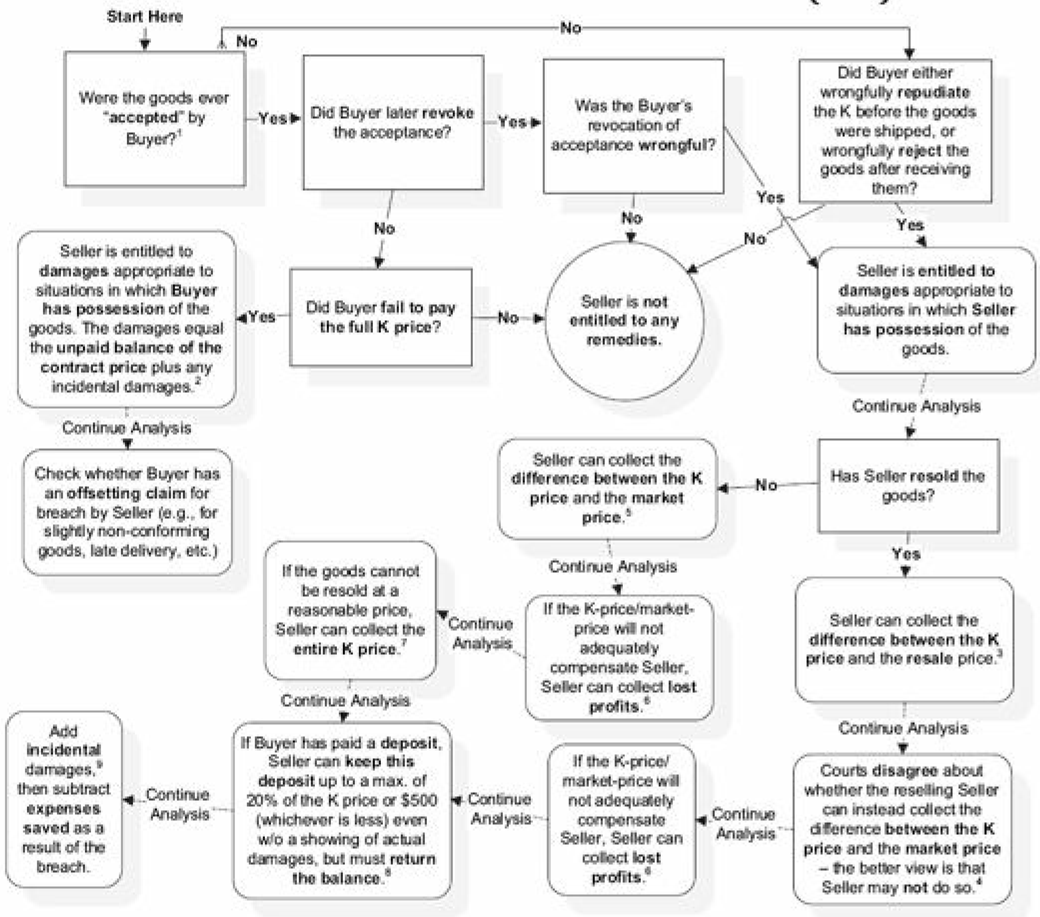
   a. **General measure of damages:** If the buyer has accepted goods and given the appropriate notification, "he may recover as damages for any non-conformity of tender the loss resulting in the ordinary course of events from the seller's breach as determined in ***any manner which is reasonable***." (§ 2-714(1).) Thus the court is given great discretion in calculating the measure of damages.

   b. **Incidental and consequential damages:** In addition to awarding direct damages, the court may award "any ***incidental and consequential damages***. . . ." These damages (discussed further *supra*, page 366) are awardable to the buyer on the same basis where he has accepted as where he has rejected or has never received delivery.

   c. **Breach of warranty:** A merchant-seller gives, according to the Code, a number of ***implied warranties***, of which the most important is the warranty of merchantability (§ 2-314). Also, any seller, whether a merchant or not, may give ***express*** warranties. Warranties, both express and implied, are discussed in the chapter on Warranties, *infra*, p. 497. If the buyer, after accepting the goods, discovers that any applicable warranty has been breached, § 2-714(2) gives him the right to recover for that breach of warranty. That section provides that the measure of damages for breach of warranty is "the ***difference*** at the time and place of acceptance between the ***value of the goods accepted*** and the ***value they would have had if they had been as warranted***, unless special circumstances show proximate damages of a different amount."

Figure 10-2

Seller's Remedies under Sales Contract (UCC)



Notes

1. See E VI(D)(4)(b) (of this chapter) for a discussion of when a buyer is deemed to have "accepted" goods.
2. Note that a buyer who has covered cannot elect to receive the "contract price minus market price" measure (shown in box to the right of this one).
3. See UCC §2-709(1)(a). For a discussion of incidental damages, see §2-714(1) and E XII(B)(3)(b).
4. See E XII(C)(2)(a).
5. See UCC §2-708(1). Marke price is determined as of the time and place for tender.
6. See UCC §2-708(2) and E XIII(C)(3). This "lost profits" measure of damages will apply most often in these 2 situations: (1) Seller is a "lost volume" seller (i.e., one who has more supply than customers, so the breach costs Seller one net sale); and (2) Seller is a middleman (and can get as much supply as needed).
7. See UCC §2-709(1)(b). This remedy will apply where the goods were custom-made for Buyer, or where the market for such goods has disappeared for some reason.
8. See UCC §2-718(2)(b). However, the amount kept by Seller may be greater or lesser than this, if there is a valid liquidated-damages clause. Id. See E XIII(C)(7).
9. See UCC §2-710; E XII(C)(5).

i. **Measure of value:** In computing the difference between the value as warranted and the value as delivered, the court will generally consider the contract price as ***conclusive evidence*** of the value the goods would have had had they been as warranted. The value of the goods as delivered, however, poses more difficult measurement problems. If the defect can be repaired, the court will probably take the ***cost of repair*** as an objective measurement of the difference between the value as is and the value as warranted. If the goods are so defective that repair is impossible, the courts will usually award the cost of ***replacing*** the goods, less the ***salvage value*** of the goods.

d. Damages not relating to warranty: In most cases the claim of an aggrieved buyer who has accepted the goods will be based on breach of warranty. But §2-714(1) (quoted above) allows the buyer to base a damage claim on the seller's failure to perform the particular obligations specified in the contract, as well as for breach of warranty. Thus, the buyer may sue for the seller's ***delay*** in delivery, the seller's refusal to ***repair*** defective machinery as promised, or the breach of any other covenant in the contract. Any loss resulting in the ordinary course of events from the seller's breach may be compensated, and may be measured in any manner which is reasonable. §2-714(1).

Quiz Yourself on
DAMAGES IN SALES CONTRACTS

104. Batman thinks the Batmobile is a little too ostentatious for everyday use, and contracts to buy a new car from the Superhero Car Dealership. He chooses a Penguin Swinger, a popular sub-compact. The cost to the dealer is $9,500, and the sticker price is $10,500, which Batman has agreed to pay. Superhero orders the Swinger from the factory, but when it arrives, Batman repudiates the contract. Superhero sells many Swingers, and it has no trouble selling the one Batman ordered to Spiderman. (Supplies of this model are freely available, and Superhero can get as many as it can find buyers for.)

(A) Under the UCC, is Superhero entitled to damages from Batman? (Ignore incidentals, reasonable overheads and saved expenses from breach.)

(B) Assume instead that Batman had custom-ordered a car with a turbocharged ejection button and hot pink leather seats. The contract price is \$20,000 and the cost to the dealer is \$19,000. After Batman repudiates the contract, Superhero decides to place the vehicle up for auction and gives Batman notice of the sale. The car goes for \$19,500. The auction costs Superhero \$250. What damages can Superhero collect from Batman now?

105. The DiCaprio Boat Supply Wholesaler contracts to deliver 500 lifeboats from its inventory to the Titanic Boat Company for \$10,000. (These models are in short supply, and DiCaprio can sell all it can obtain.) However, when DiCaprio tries to deliver the lifeboats to Titanic, Titanic wrongfully refuses to accept the shipment. DiCaprio places an ad for the lifeboats, and sells them to the I-Can Canoe Co., for \$10,000. Under the UCC, will DiCaprio be able to recover the cost of the ad from Titanic?

106. Orville Wright orders 1,000 giant rubber bands to power his airplane from Da Vinci Aircraft Supplies, for a contract price of \$1,000. When the rubber bands arrive, Wright notes that they are seriously defective (they are frayed). However, he doesn't send them back, but instead begins using them, because he doesn't want to wait for replacements.

(A) For this part, assume that Wright notifies Da Vinci of the fraying as soon as he spots it, but says that he'll keep the bands anyway. Wright uses the bands successfully in his flight, and then retires them. Wright then refuses to pay Da Vinci's bill, and Da Vinci sues for the \$1,000 contract amount. Wright counterclaims for damages for breach of warranty, and alternatively, asks the court to rescind the contract (in which case Wright is happy to return the used rubber bands and pay nothing). The frayed rubber bands (if their fraying were recognized) would have a market value of \$200. The bands were actually worth \$900 to Wright at the moment he received them, because he didn't have time to procure substitutes, and if he delayed he might not have become the first person to fly. How will the court resolve the parties' claims?

(B) For this part only, assume that all facts are the same as in part (A), except that Wright's plane crashes because the defective rubber bands break. The plane, which had a value of \$2,000, is completely destroyed. Assume that Da Vinci, being in the aircraft-supplies business, knew that a foreseeable (though not highly probable) result of using frayed aircraft rubber bands would be a crash such as that suffered by Da Vinci. Assume further that because of the extreme time pressure on Wright to be the first to fly, his decision to use the bands was not unreasonable. If Da Vinci sues for the $1,000 contract price, and Wright counterclaims for breach of warranty, what outcome?

(C) For this part only, assume that Wright receives the rubber bands, notices the fraying, realizes the danger of breakage, but says nothing to Da Vinci. He uses the rubber bands, and they break as in Part (B). Wright continues to say nothing to Da Vinci because he's busy doing other things. Finally, two months after shipment, Da Vinci sues for the $1,000 contract price, and at this point Wright first asserts (as a defense in the litigation) that the bands were frayed and caused a crash. All other facts are as in Part (B). What outcome?

107. Princess Mary is about to get married, and orders her wedding dress from the tailor who clothes her entire family, Savvy Row. The dress is to cost $3,000. When the dress is delivered, two weeks before the wedding, Mary is horrified to find that Savvy Row has cut the dress to the measurements of her grotesquely fat father, King Henry VIII, by mistake. She immediately ships the dress back (at a cost of $20) and orders the same type of dress from another tailor, Saville-Bassoon (who does not charge for shipping). Because of the short amount of time available, the replacement dress costs her $5,000.

Assuming Mary didn't pay Savvy Row anything up front, how much, if anything, will she be able to recover from them in damages?

Answers

104. (A) Yes. Superhero is a "lost volume" seller — a seller whose supply is greater than the demand. That's because Superhero will likely be able to prove that it would have made the sale to Spiderman regardless of Batman's breach: had Batman not breached, Superhero would have made *two* sales. Under § 2-708(2), a seller who would not be made whole by the contract/resale differential may recover his lost profits; lost-volume sellers are prime examples of persons entitled to use 2-708(2). Therefore, Superhero is entitled to collect its lost profits from

Batman's breach. Those profits equal $1,000 (the list price less the wholesale price).

(B) $750. Under these facts, the car in question is a unique item. Therefore, Superhero is no longer a "lost volume" seller — he could sell the custom car only once. Consequently, Superhero is no longer entitled to collect its lost profit. Superhero is now limited to more traditional seller's remedy: the difference between the contract price and the resale price, plus incidentals. Here, that is ($20,000 - $19,500) + $250 in auction costs, for a total of $750.

105. Yes. The cost of the ad (like the cost of attempting delivery to Titanic) is recoverable as "incidental damages." Note that DiCaprio is not entitled to any compensatory damages, since a seller who resells the merchandise (and who is not a lost-volume seller) receives only the difference between the contract and resale price, which here is $0 (DiCaprio got the same price from I-Can as it was expecting to get from Titanic). So incidentals will be DiCaprio's *sole* item of damages.

106. (A) It will order Wright to pay $200. First, a buyer who accepts the goods must normally pay the contract price; Wright could have rejected the shipment had he acted promptly, but by using them he lost the right to do so, and is liable for the contract price. However, Wright has a counterclaim for breach of the implied warranty of merchantability (since frayed rubber bands are not merchantable). The usual measure of damages for breach of warranty is the difference between the value the goods would have had had they been as warranted, and their actual value. The contract price ($1,000) will be highly persuasive evidence of the goods' value had they been as warranted. The "actual" value will probably be deemed to be the market value of the goods as they were, not their special value to Wright. Since that market value is $200, Wright will have a counterclaim for $800. He will have to pay the difference between the two amounts, $200 (which, not coincidentally, was the goods' market value in their defective condition).

(B) Probably a net $1,800 recovery for Wright. Da Vinci will still be entitled to the $1,000 contract price — nothing we've added to the facts of part (B) changes this. However, Wright will have a larger counterclaim for breach of warranty. He'll still be entitled to the difference between the contract price and the value of the goods as warranted (an $800 difference). But he'll *also* be entitled to the $2,000 in consequential damages (loss of the plane), an item of damages the facts tell us was reasonably foreseeable to one in Da Vinci's position. (In other words, the $2,000 is covered by the "ordinarily foreseeable" branch of *Hadley v. Baxendale*.) So Wright has a total claim of $2,800, which will produce a net judgment in his favor of $1,800 after being offset against the $1,000 contract price.

(C) Probably, judgment for $1,000 to Da Vinci. UCC § 2-607(3)(a) says that when a "tender has been accepted," the buyer "must, within a reasonable time after he discovers or should have discovered any breach *notify* the seller of breach or be barred from any remedy." So given that Wright remained silent about the breach for two months, right up until the lawsuit, a court would almost certainly conclude that Wright had failed to give notice of breach within a reasonable time after he discovered the breach. Consequently, Wright will lose his right to counterclaim for breach of warranty (see § 2-714(1), noting that the accepting buyer's right to recover damages for breach of warranty is subject to his having "given notification" under 2-607(3)). This will leave the $1,000 contract price, awarded to Da Vinci, as the sole award to either side.

107. $2,020. A buyer has the right to cover by procuring substitute merchandise. In that event, buyer's damages equal the different between the contract price and the cover price, plus any incidentals. So Mary will recover the $2,000 contract-cover differential, plus the $20 shipping expenses as incidental damages.

EXAM TIPS ON REMEDIES

The three most frequently tested subjects from this chapter are the equitable remedy of ***specific performance***, suits in ***quasi-contract***, and damages in ***sales contracts***. Be sure to bone up on these important topics.

Specific Performance

- ☛ Specific performance is the most important ***equitable*** remedy for test purposes. When reading a fact pattern, remember that the most important issue is ***whether money damages would be adequate to protect the injured party*** — if they would, that party can't get specific performance.

  - ☞ **Unique good:** Look for a ***rare or unusual object*** that's the subject of the contract — money damages are less likely to be adequate, because exact substitutes can't be found. (*Examples:* An antique car; a highly unusual ring; a work of art.)

  - ☞ **Speculative damages:** Look for cases where ***damages*** would be ***hard to measure***. This is especially likely where the contract involves a ***new business or new product.***

    Example: *S* agrees to sell *B* the rights to make commercial use of a new secret-formula sauce for hamburgers. If *S* reneges and *B* sues for specific performance, *B* will have a good chance of prevailing. This is so because, due to the formula's newness, it will be hard to predict what *B*'s profits or losses would have been for the formula, making it hard for *B* to recover money damages.

  - ☞ **Land contract:** In a straight contract for the sale of land in return for money, specific performance will normally be granted ***to the buyer***, because courts consider each piece of land to be unique, so that the buyer can't adequately be compensated by a money-damage award.

    - ☞ If the suit is brought by the ***seller*** (i.e., it's the buyer who refuses to close), note in your answer the possibility of several outcomes:
      - ☐ Some states ***allow specific performance*** to be ordered on behalf of the seller.
      - ☐ Of those who don't, some permit the seller to collect only the out-of-pocket costs incurred in making the agreement. Others permit the seller to recover only the difference between the contract price and the market price, which is often zero.

  - ☞ **Employment contract:** An ***employment contract*** is ***not*** usually enforceable (on either side) by specific performance. This is so because employment contracts are a form of personal service contract, and enforcement would violate the public policy against involuntary servitude (if the employee is the defendant) or against forcing an employer to accept services of an unwanted worker (if the employee is the plaintiff).

☛ **Liquidated damages available:** Remember the majority rule that the existence of a ***liquidated damages*** award does not bar the remedy of specific performance.

> **Example:** Buyer, a corporate transferee from out of town, contracts with Seller for the purchase of Seller's house. Because Buyer plans to move her family on April 20, the contract provides that the house is to be vacant and ready for occupancy by that date. The contract also contains a liquidated damages clause and provides for payment to Buyer of $75 for each day after April 20 that the house isn't ready for occupancy. On April 20, Buyer moves her family into town and the house isn't vacant, so they stay at a motel. On May 1, Seller informs her that he doesn't intend to go through with the contract. Buyer may sue *both* for specific performance of the land contract and for liquidated damages — since specific performance would be otherwise appropriate (it's a contract for the sale of land), the court won't deny that remedy merely because Seller is also subject to a liquidated damages clause.

Expectation Damages

☛ This is the ***standard measure of damages*** for breach of contract. Expectation damages are awarded to ***put the plaintiff in the position she would have been in had the contract been performed.***

☞ **Formula:** Expectation damages are usually calculated as:

> the ***value of defendant's promised performance*** (generally the contract price) ***less***
>
> the ***benefits to plaintiff*** (i.e., money saved) from ***not having to perform*** her end of the contract.

Hint: You should always discuss expectation damages in any fact pattern where the contract was valid and one party materially breached.

☞ *Common scenario*: A contractor ***partially performs,*** and either the hiring party obtains a substitute performance, or the contractor wants to be reimbursed for his partial work.

> *Substitute performance example:* Owner owns a farm in County. She hires Driller to drill a water well. The contract provides for a guaranteed completion by June 1.

The contract price is $10 a foot and Driller is to be paid $3,500 in advance, with any refund or additional payment to be made on completion. Two hundred feet down, Driller's drill strikes rock and breaks, plugging the hole. Driller refuses to start a new hole. Owner hires Dan to drill the well for $4,500. Dan strikes water at 300 feet.

Because of Driller's repudiation of the contract, Owner may recover the $3,500 advanced to Driller (since she got no value for that advance) *and* the $1,500 difference between the price for the substitute performance and the contract price (which would have been $3,000 for a 300-foot well).

Reimbursement example: Contractor, a building contractor, enters into a contract with Manco, a manufacturer, for the construction of a two-story factory on Manco's parcel of realty for $250,000, to be paid upon completion. When the factory is partially completed, Manco decides to retire from the manufacturing business, and tells Contractor to stop work. Contractor has already spent $180,000 on the construction and would need to spend another $35,000 to complete the building.

Contractor can collect expectation damages of $215,000, calculated as the contract price ($250,000) minus the cost to him of completion ($35,000).

<u>Reliance Damages</u>

☛ Reliance damages come into play when expectation damages would not adequately compensate the plaintiff, or where there is no enforceable contract, but plaintiff is entitled to some protection anyway. Most commonly, reliance damages generally appear on exams in questions involving ***promissory estoppel***.

☞**Example:** Buyer and Seller orally agree that Seller will sell Blackacre to Buyer for $200,000, with Seller to deliver the property with a presently-existing unsightly shed at the back removed. Seller spends $5,000 to remove the shed. At the time for closing, Buyer fails to tender the purchase price. Seller won't be able to recover contract damages, since the contract is for the sale of an interest in land, and thus was required to be in writing. However, Seller will probably be able to recover on a promissory estoppel theory, in which case he'll recover the $5,000 spend on shed-removal, since that cost was incurred in direct and reasonable reliance on the oral agreement.

<u>Restitution Damages</u>

☛ Restitution damages are defined as the value ***to the defendant*** of the

plaintiff's performance. (Think ***unjust enrichment***.) Restitution damages can be awarded in a suit ***on the contract,*** or in a suit brought in ***quasi-contract.***

> **Example (suit on the contract):** Duster, the owner of crop-dusting planes, enters into a contract with Farmer, a farmer, for the dusting of Farmer's crop four times a year for four years for a total of $10,000, which is paid upon the signing of the contract. After two years, Duster sells her business to Newco, assigning the contract with Farmer to Newco.
>
> If Newco fails to perform, Farmer may collect as damages from Duster the $5,000 unearned portion of the money paid to Duster, since Duster has been enriched by not performing the final two years. (Alternatively, Farmer could try to recover the "benefit of her bargain" — the amount, if any, by which the $10,000 contract price was less than Farmer's total payments would be by the time she procured a substitute duster for the last 2 years. But the point is that even without proof of cost-of-substitution, Farmer can recover the unpaid deposit on a restitution-damages theory.)

Quasi-contract

☛ Quasi-contract recovery is an important possibility to keep in mind whenever you are discussing the possible remedies available. Always consider relief based on quasi-contract when the ***aggrieved party is not entitled to damages for breach of contract.*** Remember that recovery will be the ***reasonable value of the services rendered.*** Watch for these situations:

- ☞ **Contract never formed:** Look for a fact pattern where an enforceable contract was never formed. The party providing the services may be entitled to recover in quasi-contract if he had a ***reasonable expectation of payment*** for those services (i.e., he did not intend them as a gift).
  - ☞ **Common trick scenario:** A party performs ***emergency services*** for a person in peril. *Usual conclusion:* The savior has performed ***without an expectation of payment*** for services or for losses incurred as a result, and therefore ***may not recover*** in quasi-contract.
- ☞ **Contract rendered unenforceable:** Look for an originally-enforceable contract that only later ***becomes*** unenforceable, i.e., where a party is ***excused*** from performing for some reason.

Although the performing party isn't entitled to contract damages, he may still be able to recover in quasi-contract. This is most likely in cases of ***impossibility/impracticability*** and ***frustration of purpose***.

Example: Owner owns a piece of undeveloped land adjacent to City Airport. On January 2, Owner enters into a contract with Architect, an architect, whereby Architect agrees to produce and deliver by May 1 a design of a ten-story hotel which Owner wishes to build on that land. On March 31, it's announced that City Airport flight operations will cease at the end of the year, making it pointless for Owner to build the hotel. Owner refuses to accept the completed hotel design from Architect on May 1.

If Owner is excused from performing because of frustration of purpose, Architect will still be able recover the reasonable value of services rendered up until March 31, when the event excusing Owner's performance occurred.

☞ **Building destroyed before completion:** Look for a fact pattern where, through no fault of either party, the structure that is being built is ***destroyed*** and the contractor refuses to begin work again:

- ☐ If the construction is of a ***new*** structure, the contractor is usually allocated the risk, so he isn't excused from performing, and therefore ***may not collect damages in quasi-contract*** for the value of the services performed through the time of destruction.
- ☐ If the construction involves a repair of an ***existing*** structure, then the contractor will probably be ***excused*** from performing because of frustration of purpose and/or impossibility, since the continued existence of the building is a basic assumption upon which the contract is based. The contractor may, in that case, recover in quasi-contract for the value of the work performed up until the time of the destruction.

☞ **Partial performance, then breach:** Quasi-contract remedies are frequently used by the party who has ***partially performed*** but then breaches a contract, as a way to set-off the damages it owes to the nonbreaching party. Look for a ***breaching contractor*** who ***hasn't substantially performed*** but has nonetheless provided the owner with something of value.

Example: O contracts to have *C*, a contractor, build *O* a house on *O*'s land. The contract price is $300,000. *C* does about half the work, then defaults. The reasonable value to *O* of the work done is $125,000. *C* has received a $60,000 deposit. It will cost *O* $225,000 to get another contractor to finish the job (meaning that if *O* has to pay the full value of *C*'s work less the deposit, *O* will be $50,000 worse off than had *C* fully performed). *C* can recover $15,000, calculated as follows:

Reasonable value of work done, less *deposit received* and less *O's damages for the breach*, or

$125,000 minus ($60,000 + $50,000) = $15,000

Consequential Damages

☛ **Extra damages:** If the standard expectation measure doesn't fully compensate a party for her losses, remember that the additional damages can also be recovered. These are often called ***"consequential"*** damages.

Example: C agrees to renovate O's house for $50,000, by March 1. C gets a $25,000 deposit, does half the work, then defaults. O hires a replacement, X, who finishes the job for $25,000. The standard expectation "benefit of the bargain" measure would give O $0 recovery, because there is no difference between the contract and market price. But if X can't finish the job until April 30, and O can't move in during the month of April, O will probably be able to recover the cost of procuring substitute lodging for that month — the lodging costs will be "consequential" damages, and will be on top of the contract/market differential.

☞ **Foreseeability:** But remember that consequential damages are subject to an important limitation: the requirement of ***foreseeability***. Determine whether the additional losses were either: (1) ***reasonably foreseeable*** to an objective observer in D's shoes, based on general principles; or (2) foreseeable based on the plaintiff's ***special requirements,*** of which D had ***notice***. (Remember that this is basically the rule of *Hadley v. Baxendale*.) If the losses don't fall into either category, they're not recoverable.

Example: Seller and Buyer enter into a contract for the sale of 10,000 pounds of specifically described bolts each month for a period of ten months beginning March 1; the contract has a total value of $40,000. On March 1, Seller informs Buyer that he will not deliver any bolts to Buyer because he has just contracted to sell his entire output to another buyer for a higher price. It takes Buyer 61 days to find a new supplier; the new supplier charges the same price. Because of the delay in finding a new supplier, Buyer is late in delivering motors to End User, a company with which Buyer has a contract containing a valid liquidated damages clause providing for damages of $10,000 a day for delays in delivery of motors. Although

Seller knew that Buyer sold motors, Seller didn't know about Buyer's specific contract with End User. May Buyer recover from Seller the $610,000 he is required to pay End User under the liquidated damages clause?

Probably not, because it probably wasn't foreseeable to Seller that a 2-month delay in delivery on a $40,000 contract would bring about $610,000 in losses. Buyer's needs — in particular his need to avoid heavy liquidated damages — were probably "special requirements" that cannot be the basis for recovery unless Seller knew about them at the time of contracting.

Mitigation

☛ Be sure to discuss whether the nonbreaching party has attempted to ***mitigate damages*** in a situation where the loss was partially or totally avoidable — if she didn't, any damages that would probably have been avoided by such an attempt are non-recoverable.

- ☞ Look for a ***terminated employee,*** who fails to make reasonable efforts to find a suitable ***replacement job***.
- ☞ Look for a ***disappointed buyer or recipient of services***.

Example: B, the owner of a furnace-repair company, maintains a fleet of personal trucks for his employees' use and drives his personal station wagon when visiting customers' homes. On February 15, *B* orders a new station wagon from *S*, a car dealer, to be delivered by March 5. On March 4, *B* sells his old station wagon because of the expected delivery of the new car the following day. However, the new car isn't delivered to *S* until March 30. *B* sues *S* for lost profits because of his inability to travel to customers. *B* won't recover for this: although business losses were foreseeable at the time of contracting, *B* could have mitigated his damages by renting a car or using one of the company's trucks.

Liquidated Damages

☛ **Reasonableness:** Remember that the liquidated damages amount will be deemed (in most courts) reasonable if it is a reasonable estimate as of ***either*** the ***time of contracting*** *or* the ***time of the actual loss.*** Normally, you should try to analyze the reasonableness as of *each* time frame.

☛ Other points to watch for:

- ☞ Pay attention to what the clause remedies. Even where the clause is enforceable, other types of damages can still be awarded to address problems not covered by the clause.

Example: *O* and *C*, a contractor, enter into an agreement for various repairs to be made to *O*'s home. The contract provides that the repairs are to be completed within sixty days, and that if *C* fails to complete the job on time, *C* will pay *O* $50 per day as liquidated damages. After the repairs are finished, *O* discovers that *C* did a faulty job on one aspect, the roof; she has another contractor redo the repair for $1,000. Since the liquidated damages clause only redresses *late* performance, it doesn't eliminate the possibility of *O*'s collecting damages for *defective* performance in the amount of $1,000.

- ☞ Be on the lookout for ***"blunderbuss"*** clauses, where the clause gives the ***same damage award regardless of the severity*** of the breach. Such a clause is likely to be a penalty, at least where it ends up costing D much more than the ***actual*** damages she's caused.

  Example: Boss is a CPA and Emp is his employee (also a CPA) under a 2-year contract. As part of the contract, Emp agrees to a non-compete, under which if Emp leaves and does work for any client of Boss during the 2 years, Emp owes Boss damages equal to three months' salary ($30,000). Emp quits and, with 1 week left in the 2 years, does $100 of work for one client of Boss. This "blunderbuss" clause (same $30,000 of damages assessed regardless of how much the competition cost Boss in lost revenues) will be found to be an unenforceable penalty.

Damages in Sales Contracts

- ☛ **Buyer's damages:** This area is more heavily tested than that of seller's damages. Several reminders:
  - ☞ **Standard "contract/market" differential:** If a buyer returns defective goods (or fails to receive any shipment of goods from the seller) and doesn't purchase replacement goods elsewhere, she is entitled to the difference between the ***contract price*** and the ***market price*** at the time of breach.
  - ☞ **Cover:** If a buyer returns defective goods (or fails to receive any shipment of goods from the seller) and ***purchases them elsewhere***, she is entitled to the difference between the ***contract*** price and the ***cover*** price.
    - ☞ The buyer's ***cover price paid by the buyer must be reasonable in the circumstances***. Look the buyer's attempts to find a good price (or at least to verify the true "market" price) — if these are absent, discuss the possibility that the buyer may have behaved unreasonably and should be denied the full contract/cover differential.

- Remember that if the market price (or the cover price) and the contract price are the ***same***, ***there are no damages to collect***, except consequential or incidental ones.
    - *Note:* Where the market price or cover price is *less* than the contract price, the buyer gets the benefit of the difference with no off-setting to what the seller owes for consequential or incidental damages.
- **Breach of warranty:** If a buyer accepts defective goods the damages are calculated as the difference between the value which the delivered goods had at the time of acceptance and the value which conforming goods would have had at the time.
- **Specific Performance:** The buyer can only get specific performance if the goods are ***unique***.

- **Seller's damages:** The most testable issue in this area is whether a seller can be compensated for ***lost profits***. *Trick:* The seller appears to have suffered no damage because he resold the item or items for the contract price or for an amount in excess of the contract price. Your inquiry should not end there, however.
    - Look for a seller who has a ***supply of goods in excess of the level of demand*** (the ***"lost volume"*** seller). He has lost a sale and is entitled to his lost profits — even if he resold the goods in question — because he could have had *both* sales but for the breach.
        - But if the seller resells *all* the available goods of the type that is the subject of the contract, then he is not a lost-volume seller and cannot collect lost profits for the breach.
- Remember to deduct from all recoveries the ***costs*** that the aggrieved buyer or seller ***didn't incur*** as a result of not having to complete his performance.

Punitive Damages

- Remember that punitive damages are ordinarily ***not recoverable*** in breach-of-contract actions. (However, if the breach was also independently a tort — as in fraud — punitives may be recoverable.)

[1]. If the work has been completed, the builder will simply recover the contract price less any prior payments made by the owner.

EXAMPLES & EXPLANATIONS

Contracts

Seventh Edition

Brian A. Blum

Wolters Kluwer

CHAPTER 18 Remedies for Breach of Contract

§18.1 THE SCOPE OF THIS CHAPTER

Because a contract creates obligations enforceable in law, its breach by one of the parties entitles the other to commence action to enforce it. This action may be a suit in court or, where parties have so agreed, may be by some form of alternative dispute resolution, such as arbitration. This does not mean, of course, that the victim of a breach will inevitably take enforcement action. For most people, litigation or arbitration to enforce the contract is usually the last resort, after it becomes clear that the breach cannot be resolved by less formal means, such as a request to rectify the breach or by negotiation. Even where informal resolution fails, the victim of the breach may decide not to seek enforcement of the contract for any of a number of reasons. For example, this may damage an important relationship between the parties, or the amount at stake is too small to justify the expense of litigation or arbitration, or it will be too difficult to prove economic injury, or the breaching party has no funds or other assets available to pay any judgment or award that may be obtained. Although these considerations should always be borne in mind, they are not addressed here. It is the concern of this chapter to set out the policies, general principles, and rules that govern the choice of remedy for breach and the measurement of compensation. We therefore focus on the judicial enforcement of the contract following its breach.

This chapter examines the remedies available for breach of contract. It presupposes that a valid and enforceable contract has been entered into and that one of the parties has breached it materially and totally.[1] (If your contracts course covers remedies at or near the beginning, you will not yet have studied formation, performance, and breach, but you do not have to know those topics to understand this chapter.) Remedial issues fall into three distinct but interrelated inquiries: First we must determine the nature and extent of the plaintiff's compensable loss, including both the harm suffered and the availability and form of the legal remedy or remedies to redress it. Second, if there is more than one means of remedying the loss, we must decide which of the available remedies most efficiently and comprehensively compensates for it. Finally, we must take into account any policies or principles that may limit the defendant's liability for the loss.

§18.2 THE BASIC GOAL OF REMEDIES FOR BREACH: ENFORCEMENT OF THE EXPECTATION INTEREST

§18.2.1 The Nature of the Expectation Interest

A valid and enforceable contract justifies a future expectation by each of the parties. They are both entitled to expect that the other will honor the contractual promise made and will perform as undertaken. If one of the parties fails to do so, thereby breaching the contract, the expectations of the other have been disappointed. Therefore, the fundamental goal of the remedy for breach is to cure that disappointment by giving the victim of the breach what was promised and justifiably expected under the contract, usually in the form of a monetary award that approximates its value. This starkly contrasts contract damages from those for tort: While tort damages seek to compensate for something lost—to restore the victim to the pre-injury position—contract damages aim at compensating for something that was not gained—what the plaintiff should have had. This goal of enforcing contractual expectations is the beacon that guides contract remedies. The principle is described in a number of alternative ways, all of which have essentially the same meaning: Sometimes it is said that the goal is to protect the plaintiff's expectation interest; sometimes it is described as giving the plaintiff the benefit of her bargain; and sometimes it is said that the purpose of contract remedies is to place the victim of breach in the position that she would have been in had no breach occurred. This goal of damages applies both at the common law and under the UCC, which codifies it in §1.305.

A party's expectation interest is the value of the performance to her, based on the purpose of the contract, as gleaned from its wording and the circumstances surrounding the contract's formation. However, even though the expectation interest is based on the contractual expectations of the particular party aggrieved by the breach, it is not determined on the purely subjective criterion of her privately held, subjective belief about what she would derive from the contract. Contracts are interpreted objectively, and compensation for breach is determined on the basis of objective evidence of loss. Therefore, a party's compensable expectations must be in accordance with what a reasonable person in her position would have expected as the benefit of the transaction, given the language used by the parties to express their agreement, and the circumstances surrounding it.

§18.2.2 An Introduction to the Means of Enforcement: The Primacy of Monetary Compensation over Specific Relief

The most direct and accurate way of enforcing the plaintiff's reasonable expectations under the contract would be for the court to grant an order of specific performance of the contract. This is an order to the defendant requiring him to perform as promised. For example, Harpo C. Cord owns the only extant piano known to have been used by Chopin. He entered into a contract with Nick L. Odeon under which he agreed to sell it to Nick for $25 million. Harpo breached the contract by refusing to go through with the sale. Nick's expectation is to gain the piano in exchange for depleting his bank account by $25 million, so the most accurate means for the court to ensure that he achieves that expectation is to issue an order of specific performance that compels Harpo to deliver the instrument against payment of its price. This seems like the most obvious solution, and on these facts—because the piano is unique—the court may see this as the most effective and desirable resolution. However, specific performance is not the norm. It is reserved for unusual cases where damages are shown to be incapable of adequately compensating the plaintiff.[2] More commonly, the plaintiff's disappointed expectations are compensated for by an award of money.

Why does the law prefer a money equivalent of expectation over the real thing? The answer lies partly in considerations of practicality and policy, and partly in the traditional dichotomy between law and equity. The practical and policy issues may be illustrated by the following example: Sara Nade, an aspiring singer, had entered a singing competition in the hope of winning first prize, the chance to sing the national anthem at an important sports event. To give herself the best chance of winning, she contracted with Harmony R. Peggio, a voice coach, to receive an intensive period of voice training in the week before the competition. Under their contract Harmony undertook, for a fee of $1,500, to give Sara four hours of coaching every day in that week. A few days before the course of instruction was to begin, Harmony notified Sara that she would be leaving town to do a last-minute concert tour, so she could not give the lessons as promised. Sara's expectation interest is to have the lessons for $1,500, and therefore the most accurate way of ensuring that Sara gets exactly what she expected would be for a court to compel Harmony to decline the tour and to give the promised lessons. However, in this situation the remedy of specific performance presents a number of problems: It would be difficult for the court to ensure that Harmony put her best efforts into a job that she is forced to do; the compulsion takes on the aspect of involuntary servitude; and the solution is not very efficient if another teacher could be found instead. For these reasons, it makes sense to allow Harmony to go on her tour, but if her breach results in a loss to Sara, to hold her liable to compensate for that loss.

As noted earlier, the preference for monetary relief is not based only on concerns of practicality, forced labor, and efficiency. Even if none of these problems exists, our legal tradition emphasizes damages as the standard remedy for breach of contract and disfavors specific relief in all but the most compelling circumstances. This is because the award of money damages was a remedy that could be granted by courts of law, whereas specific performance was granted only by a court of equity. (The distinction between law and equity is explained in section 2.5 and is discussed further in section 18.10.1.) Courts of equity were intended to intervene only when the available remedies at law were inadequate, and therefore a plaintiff who sought the equitable relief of specific performance was required to show that the nature of her expectation interest was such that the only means of achieving adequate relief was by the specific enforcement of the contract. Although courts of law and equity were merged some time ago, this ancient distinction still haunts our decisionmaking. As a result, even if it is practicable to give the plaintiff precisely what she expected, a money substitute is used in the great majority of cases: The plaintiff is awarded a sum of money that aims, as closely as possible, to put her into the economic position she would have been in had the contract been performed.

What is the basic principle on which this monetary award is calculated? To illustrate it, let us add some facts to the case of Harmony's breach of the voice-training contract: After Harmony's breach, Sara was able to find another voice coach, who was available to give her equivalent lessons for the same amount of time, but who charged $1,800 for the course. By hiring him, she got the lessons that she expected but had to pay $300 more for them. So, to place her in her expected position, damages of $300 must be awarded against Harmony. Of course, this is not exactly Sara's expectation, because the teacher was different. However, we can seldom achieve the plaintiff's exact position by paying her money. The aim is to get as close as possible. It should also be apparent that the concern here is only with economic loss, so if Sara could obtain the equivalent lessons at exactly the same price as Harmony charged under the contract, she has suffered no financial loss at all and is entitled to no damages for the breach.

§18.2.3 Fundamental Principles of Expectation Relief

The above examples suggest a number of important basic principles which will be recurring themes of the discussion that follows.

a. The Achievement of the Plaintiff's Expectation Is an Approximation

Contractual remedies aim to place the plaintiff in the position she would have been in had there been no breach, but because specific performance is available in only limited circumstances, the precise attainment of that expectation is seldom achieved. The best a court can do, in most cases, is to try to determine, as closely as possible, what monetary award will approximate that result.

This is already clear from the discussion of Sara's employment of a substitute voice coach. The monetary award provides her with the compensation of getting the same hours of instruction for the same price, but it does not give her the less tangible benefit of being instructed by the teacher that she bargained for. The facts of the example, having been drawn with deliberate simplicity, do not illustrate some of the additional difficulties that may get in the way of an accurate measure of the value of the expectation. We will consider these later. For the present just bear in mind that the more complex the facts become, and the more uncertain the consequences of breach are, the harder it is to determine the amount of damages necessary to approximate the plaintiff's rightful position. Sometimes the amount awarded may undercompensate the plaintiff, and sometimes it may overcompensate her. It is important to remember that the burden of proving damages is on the plaintiff, who bears the ultimate risk of failing to persuade the factfinder about the fact or extent of loss. This burden is alleviated in some situations by evidentiary presumptions or inferences.

b. The Economic and Moral Dimensions of Contract Remedies

Contract law strongly emphasizes monetary compensation for the financial consequences of breach. In the discussion of Harmony's breach, no mention was made of any award for Sara's aggravation, inconvenience, or emotional distress in trying to cope with this last-minute letdown and in finding a replacement for Harmony. Unlike tort law, which is very solicitous of emotional trauma, contract law is dry-eyed and coldly commercial. It does not, except in the most unusual cases, take any account of noneconomic injury.

It is implicit in the principle that contract law compensates only for economic injury—that there is usually no sanction for a breach that causes no economic loss.[3] This may be disturbing to one who approaches this chapter after having spent so much effort learning that contractual obligations are binding and legally enforceable. Nevertheless, this is a basic truth of contractual remedies. If the contract is not one of the few that qualifies for specific enforcement, and no economic loss can be established, a breach normally results in no legal liability. (Of course, a breach may nevertheless carry some adverse nonlegal consequences, such as loss of goodwill or reputation.)

It follows naturally from this that damages measured purely by the extent of the plaintiff's loss do not generally distinguish between breaches that are inadvertent and those that are willful and purposeful. Because the focus is on rectifying harm and not on sanctioning improper conduct, punitive damages are not typically available for a breach of contract (except in unusually egregious cases), even when the violation of the contractual duty was deliberate. However, there are some rules of contract law that have particular or stricter application where a breach is willful or has an immoral dimension. In addition, there are various ways in which the court's or jury's disapprobation of the breacher's conduct might be more subtly reflected in the disposition of the case. For example, a court may use flexible rules to shift the burden of proof or otherwise give a plaintiff some advantage where the breach was purposeful, and a jury usually has enough leeway to be more generous to the plaintiff in awarding damages against a defendant whose breach was calculated and unethical.

c. The Economic Justification for Confining Damages to Financial Loss: The Concept of Efficient Breach

Although the principle of confining damages to financial loss predates the widespread resort to economics to explain, criticize, or justify legal rules, economic analysis of remedial principles has become common. One of the concepts derived from economics is efficient breach. A breach of contract is said to be efficient if the defendant's cost to perform would exceed the benefit that performance would give to both parties. Where this is so, the defendant makes enough gains by breaching to enable her to pay compensatory damages to the plaintiff and still come out ahead. Provided that one looks only at the economic impact of the breach, one can say in such a case that the defendant's breach does not harm the plaintiff, who receives the financial benefit of his bargain, and yet it improves the defendant's position. In this sense, it satisfies the criterion of economic efficiency in that it makes the defendant better off without making the plaintiff worse off. If this is true, it could be argued that a rational contracting party with full information will choose to breach where circumstances make the breach efficient. This leads to the argument that the law should not discourage this because a legal rule that permits efficient breach—such as the rule that a plaintiff is entitled only to damages for economic loss—is itself efficient and thus best serves the interests of society.

Although analysis of this type is of some help in understanding and justifying the approach to contract damages, it has many limitations. The most significant is, of course, that it takes into account neither important noneconomic values (such as reliability, fair dealing, or faithfulness) nor those consequences of breach that are not measurable in economic terms (such as inconvenience, disappointment, or frustration). As a result, a conclusion that a breach imposes no harm on the plaintiff or on society may be misguided if based purely on quantifiable financial considerations.

Furthermore, economically efficient decisionmaking can only be achieved if all the conditions are right: The market must be competitive and stable, so that the relative costs and benefits of performing and breaching can be gauged. The party contemplating breach must be capable of acting voluntarily and rationally, and must have sufficiently full and reliable information to enable her to make a prediction of likely losses and gains. In addition, the transaction costs (including possibly significant legal fees) involved in terminating this contract and making substitutes must be small enough so as not to eliminate any advantage achieved by the breach.[4] Such ideal conditions are seldom likely to exist, which means that it will often be difficult to know at the time of breach whether it will turn out to have been economically efficient. Even if the party predicts an advantageous outcome at the time of the breach, economic conditions and subsequent circumstances may render it otherwise. To the extent that a theory of efficient breach is predicated on an unrealistic assumption of rational, voluntary, and informed behavior in a perfect market, with negligible transaction costs, it is likely to be unreliable and more an academic model than a reflection of reality.

§18.2.4 The Enforcement of a Damage Award

The illustrations in section 18.2.2 do not indicate what happens after Sara gets her judgment of $300 against Harmony. The means of collecting payment on a judgment is beyond our scope, but it is useful to describe it briefly to provide an overall picture of the enforcement process. After the judgment is obtained (or if appealed, once it is affirmed on appeal),[5] Harmony may pay it voluntarily, thereby ending the matter. If she does not, Sara's only means of enforcing the judgment is to have a writ of execution issued by the clerk of the court to the sheriff (or equivalent official), calling on that official to find, seize, and sell property owned by Harmony to satisfy the judgment. The sheriff tries to execute the writ by finding property sufficient to satisfy the amount of the judgment, taking custody of it (known as levying upon it), and selling it at public auction. The proceeds of the sale are then paid to Sara, less the costs of execution. There are variations of this procedure that need not concern us here.

The point is that a judgment itself is merely a finding of liability. It does not guarantee that the plaintiff will get paid. If the defendant fails to satisfy it, and no assets can be found to execute on, the plaintiff may never see her money. This sobering reality must be taken into account by anyone who decides to initiate litigation, and it means that being able to establish breach and damages are only part of the problem of enforcement. A judgment in law for damages is said to be *in rem*—it is enforceable only against the property of the defendant, and if the defendant has no property, the plaintiff loses in the end, having incurred substantial legal costs in the process.

§18.3 THE CALCULATION OF EXPECTATION DAMAGES

It is essential to bear in mind that the aim of expectation damages is to simulate as closely as possible the plaintiff's economic situation in the absence of breach. To determine the amount of money needed to approximate that position, a comparison must be made between what the plaintiff had the right to expect and what she actually got. Although the facts needed to calculate these two points of comparison can be very complicated and sometimes immensely difficult to prove, the basic concept of the comparison is straightforward. If one does not keep it in sight and use it constantly as a yardstick, one risks getting lost and confused.

Different formulas have been devised for use in making the comparison. These formulas are really just checklists to remind one of the factors to be taken into account, and they are only helpful to the extent that they do reliably cover every component of the calculation and signal clearly what figures go into each of them. A particular formula may be specific to certain kinds of cases and may not work well in others. In general, there are two essential elements to any formula, no matter how it structures the calculation: One part of it will count up the plaintiff's losses caused by the breach, and the other will take into account any savings, gains, or recoupments that she has made as a result of termination of the contract. Damages consist of the losses less the savings, gains, and recoupments. Restatement, Second, §347 suggests the following general formula:

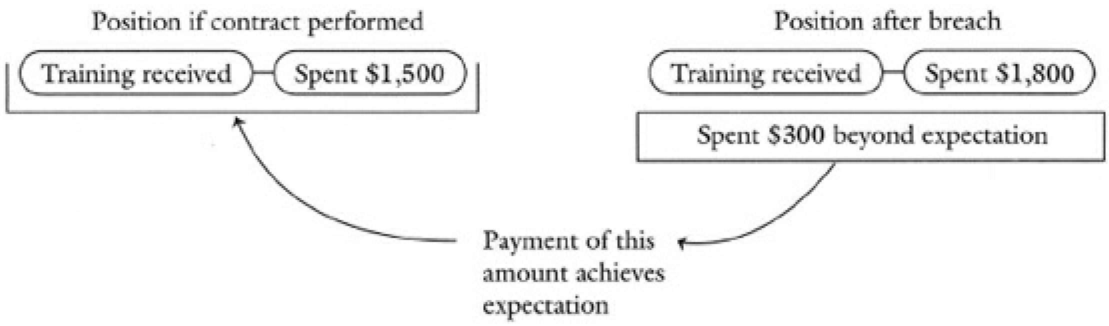
> Damages =
> **Plaintiff's loss in value** caused by the defendant's nonperformance
> (This is determined by deducting the contractual value of what the plaintiff received from what she was promised)
> Plus
> Any **other loss**
> (This includes consequential and incidental damages)
> Less
> Any **cost or loss** the plaintiff **avoided** by not having to perform

The principles and method of calculation are best explained by some concrete illustrations that describe some different types of situations and the various considerations that must be taken into account under each of them. Note that the actual ingredients of the calculation shift in accordance with the nature of the contract in question, but that the basic inquiry is always the same—the determination of damages always revolves around a comparison between the plaintiff's rightful position under the contract and her actual situation as a result of the breach.

a. Damages Based on a Substitute Transaction

We have already seen that in her simple contract for the purchase of voice training services, Sara's damages could be calculated by measuring the difference between what it would have cost her to receive the services under the contract, and what it ultimately cost her to obtain equivalent services elsewhere. That is, had the contract not been breached by Harmony, she would have had 28 hours of voice training for $1,500. As a result of the breach, she had 28 hours of training for $1,800, so damages of $300 puts her in the position she would have been in had the contract been performed. This is represented in Diagram 18A.

Diagram 18A



Exactly the same calculation and result would occur if, instead of purchasing lessons for $1,500, Sara had bought a car from Harmony for that price, Harmony breached by refusing to deliver, and Sara managed to find an equivalent substitute on the market for $1,800. UCC §2.712 codifies this by expressing the buyer's damages as the difference between the cover (i.e., repurchase) price and the contract price.

Change the facts: It is Sara who breached by canceling the lessons, and Harmony entered a substitute transaction by taking on a new student to fill the slot left open by Sara's breach. The same principle applies, but because the plaintiff is the provider of services, damage results only if the gains from the substitute transaction are less than those expected from the breached contract. For example, assume that Harmony could not find a replacement student at Sara's advanced level, and so she accepted a more junior student at the lower rate of $700 for the 28 hours. Harmony would be entitled to damages of $800, calculated by deducting the $700 earnings under the substitute contract from the $1,500 she expected to earn under her contract with Harmony. Similarly, a seller of goods who reasonably resells the goods at a lower price following the buyer's breach is entitled under UCC §2.706 to the difference between the contract price and the lower resale price.

b. Damages Based on the Market Value of the Promised Performance

Under both the common law and the UCC, if the aggrieved party did not enter into a substitute transaction, she is entitled to sue for loss based on a hypothetical substitute, valued at the market rate (which would have to be established by testimony, typically of an expert witness). Therefore, if, after Harmony's breach, Sara decided not to find a replacement teacher, and if the market value of the lessons is higher than what Harmony charged her, she could still sue Harmony for the difference between the market value of 28 hours of equivalent instruction and the contract price. Even though she is not actually going to pay more, because she will not have any lessons, she has nevertheless lost the benefit of a transaction below the market value, and can be compensated for this loss of benefit. The same principle applies under the UCC. Section 2.713 allows the buyer the difference between the higher market price of the goods and the contract price and §2.708(1) provides for seller's damages measured by the difference between the contract price and the lower market price of the goods.

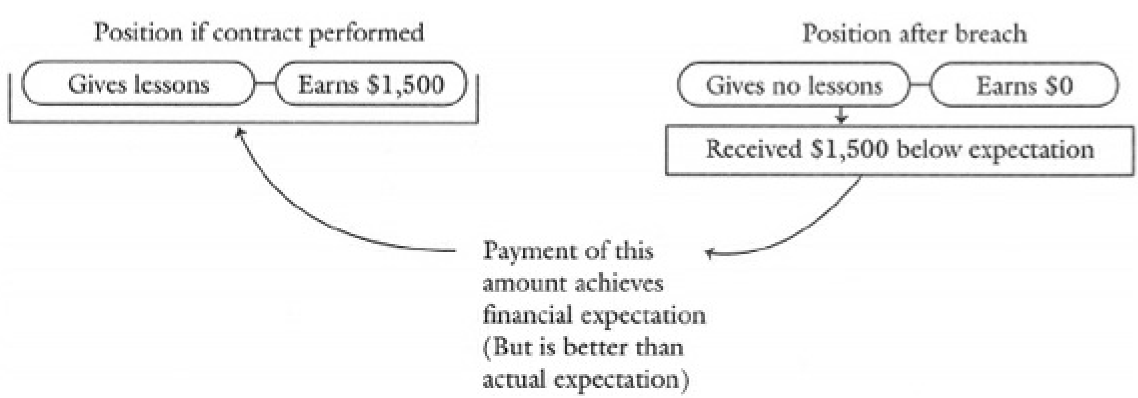
The market price may also be used as the basis for calculating damages when the plaintiff did enter a substitute transaction, but the principle of mitigation, discussed in section 18.6.3, makes it inappropriate to award damages based on the actual cost of the substitute because the cost of the substitute transaction was higher than it needed to have been. This may happen when the market was rising and the plaintiff waited too long before making the substitute contract, or she chose an unreasonably expensive substitute. For example, following Harmony's breach, Sara hired a substitute teacher for $1,800, but that teacher charges more than the market rate of $1,600. If Sara could reasonably have found a teacher at the market rate, her damages will be confined to $100. This principle applies under the UCC as well and is reflected in UCC §§2.706 and 2.712, which require resale or cover to be without unreasonable delay and on reasonable terms.

When market value is used as the basis of determining damages, it must be decided at which place and time the value must be determined. If the parties reside in the same place and the performance was to occur in that place, there is no problem in deciding on the locality of the market, but if more than one location is connected to the contract, it must be decided which one should be used to measure market value. In addition, a market may fluctuate, so it is necessary to decide the date on which value is to be measured. There are different views on the most appropriate choice of market, and some inconsistency on this issue between the common law, the treatment of the seller under UCC §2.708, and the treatment of the buyer under UCC §2.713. Without getting into that complexity, it may simply be observed that the most sensible approach is to use the time and place that most closely approximates the market that the aggrieved party would reasonably have entered to obtain the substitute.

c. Loss of Income in a Contract for Services

Sometimes it may not be possible for the victim of a breach to find a substitute transaction. If the contract is for services, such as an employment contract in which the employee's only performance is her labor, and if the employee cannot find another job, a breach by the employer results in the employee's loss of her entire expectation under the contract. In such circumstances, the only way to compensate for the employee's disappointed expectation is to award damages equivalent to the full consideration due to her under the contract. For example, a few days before the voice training lessons are to begin, Sara reneges on her contract with Harmony because she decides that she does not need voice training. At this late date, Harmony cannot find another pupil to substitute for Sara, so she loses 28 hours of gainful employment. Sara would have come to Harmony's home for the lessons, and Harmony would not have incurred any costs in performing the service. That is, the full $1,500 would have been profit to her. Had the contract been performed she would have spent nothing and gained $1,500; now she still spends nothing, but gains nothing. Therefore, a payment of $1,500 is needed to give her the benefit of her bargain. Of course, this award really puts her in a better position than the contract would have done, because she does not have to work for it. But this is not taken into account when her only gain—not having to work for her fee—has no monetary significance. *See* Diagram 18B.

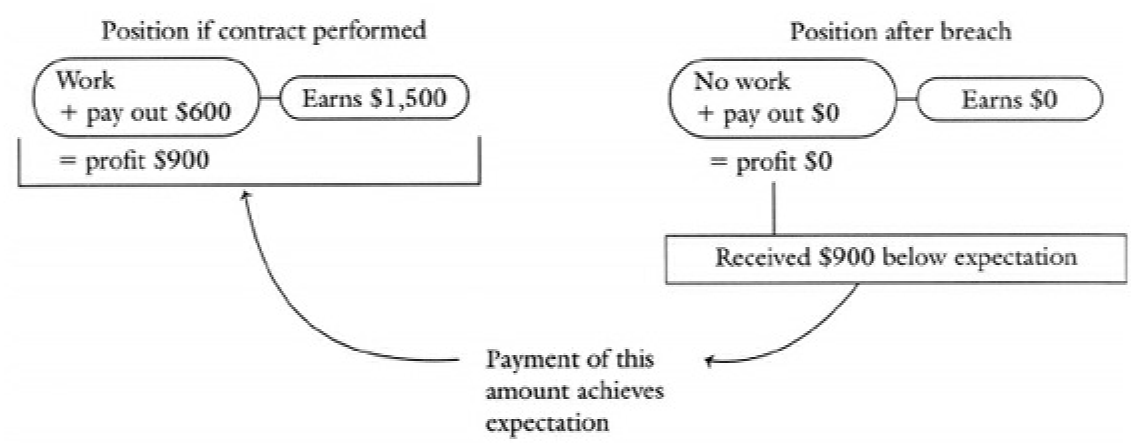
Diagram 18B



d. Savings Resulting from the Breach Must Be Offset Against Loss

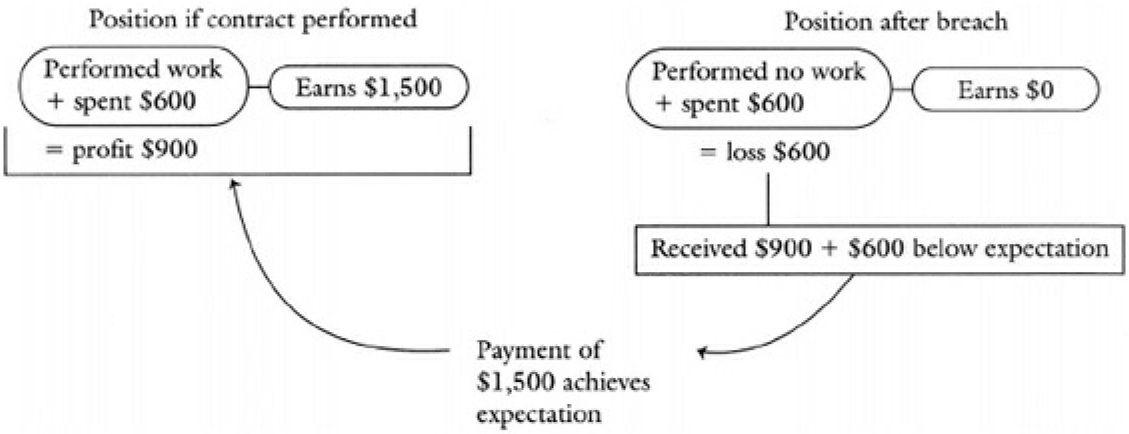
The result in the above example would be different if Harmony would have had to incur costs to perform. Say that she would have needed to hire an accompanist for $600 to play the piano during the lessons and she is able to avoid doing so as a result of the breach. This cost, which is incurred solely in the process of and for the purpose of performing her contractual obligation to Sara, is known as a direct or variable cost. It must be distinguished from fixed cost or overhead, such as Harmony's rent or utilities, which would have to be paid whether or not she performed this contract, and is hence not saved by the breach. Because direct costs would have reduced her expected profit had the contract been performed, it stands to reason that because they are actually saved as a result of the breach (or could have been saved if the plaintiff acted reasonably), they must be deducted from expected gains to achieve true expectation. This concept is represented by Diagram 18C.

Diagram 18C



Of course, she must have been able to save the costs by reasonable action. The above example assumed that Harmony had the right to cancel her contract with the accompanist, thereby avoiding that direct cost. However, if she could not cancel without incurring liability to him for his fee (that is, she had made an irrevocable contractual commitment to him) she would not save these costs as a result of Sara's breach, and they would not be deducted. This is represented by Diagram 18D.

Diagram 18D

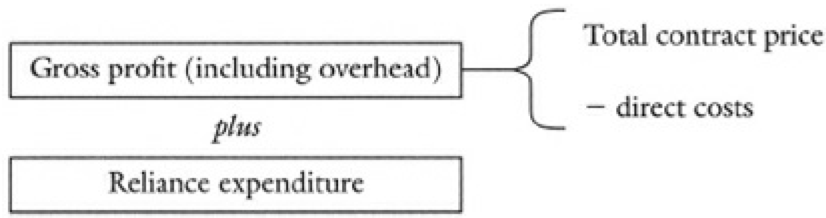


The same result would be reached if, instead of a contract for the provision of services, we were dealing with a sale of goods to be manufactured by the seller. If the buyer breached before the fabrication has begun, so that the seller avoids the direct costs of making the goods, the seller's damages are its lost profits on the sale, calculated by deducting the costs saved from the contract price.

As noted earlier, fixed costs (overhead expenses) are not saved by the breach and are not therefore deducted from damages. The above calculations therefore do not take into account costs such as the rent that Harmony paid for her studio or any other expenses that she had to incur in the course of her business, whether or not she taught Sara. Therefore, when we talk of the recovery of profit in a case like this, we mean gross, not net, profit.

In the first of the above illustrations, Harmony could avoid the direct cost of hiring the accompanist, so her damages are pure profit. But in the second, because she could not save this direct cost, her recovery includes both her expected profit and the reimbursement of the wasted expenditure that she incurred (or was committed to pay) in reliance on the contract. In a situation like this, when the plaintiff has incurred the expense of partial performance before the breach, a convenient formula for calculating expectation damages is therefore as shown in Diagram 18E.

Diagram 18E



e. Offsets for Part Payment and Salvage

Any payment that the plaintiff received under the contract, as well as any loss that she may be able to salvage, is treated in the same way as costs that she has saved—these amounts must be offset against her recovery. For example, some months before the singing competition, and in anticipation of winning it and becoming an internationally renowned star, Sara decided to build a fully equipped recording studio onto the back of her house. She had the plans drawn, and entered into a contract with Ken Tractor to construct it for a total price of $75,000. The contract required Sara to make a down payment of $5,000 and to pay the remainder of the price in installments as the construction proceeded. Sara made the down payment, and Ken began work about two weeks before the competition. On the eve of the competition, he had reached the stage of completing the foundation and the framing of the new studio. Sara did not win the competition, and she immediately terminated the contract for construction of the studio. She had no right to do this, so she has breached. At that point, Ken had received only his initial payment of $5,000. His costs in material, laborer’s wages, and subcontractor charges to date were $10,000. He can show that had he completed the studio, his total direct cost would have been $60,000. The above formula leads us to a damage recovery of $20,000:

Gross profit	Contract price	$75,000
	– total direct cost	$60,000
	=	$15,000
Plus reliance expenditure	+	$10,000
Total (profit + reliance)	=	$25,000
Less payments received	–	$5,000
Recovery	=	$20,000

If you make the comparison between Ken's expected position and his position following breach, as we have done in prior illustrations, you will find that the payment of $20,000 achieves his expectation.

Consider a different case: Sara decided to have a special evening gown made for her appearance at the competition. She contracted with Cadenza La Scala, a dressmaker, for the manufacture of the dress for $1,500. Sara paid a deposit of $150 to Cadenza. After Cadenza had begun work, Sara decided that she had been profligate in ordering such an expensive outfit and decided to use an old prom dress instead. She immediately told Cadenza to stop work, thereby breaching the contract. At that stage, Cadenza had spent $200 on fabric that she had cut according to the pattern designed for Sara. In its present form, the cut fabric could be sold as scrap for $5. If Cadenza completes the dress, she will have to spend a further $50 on materials, but it would be very hard to sell the completed product because it was cut to fit Sara and it reflects her peculiar and rather eccentric fashion sense. This contract is a sale of goods, and UCC §2.708(2) codifies the formula set out above. Before looking at §2.708(2), we should note that as a manufacturer of the goods, Cadenza has the option under §2.704(2) of either scrapping the dress or of completing it and selling it to someone else. In making this choice, she must exercise commercially reasonable judgment. She would be justified in completing and attempting to resell the dress if she reasonably believed that by doing so, she could recoup all or most of the profit lost by Sara's breach, thereby reducing or eliminating her damages. As there is unlikely to be a ready market for such an idiosyncratic piece of clothing, the more reasonable judgment would be to scrap it and to seek damages under our formula, which is adopted in §2.708(2). Her recovery would be:

Gross profit	Contract price	$1,500
	– total direct cost	$250
	=	$1,250
Plus reliance expenditure	+	$200
Total (profit + reliance)	=	$1,450
Less payments made ($150) and salvage ($5)	–	$155
Recovery	=	$1,295

Sara's down payment is, of course, an offset, as it was in the prior example, but the salvage must also be included in the deduction because it is, in a sense, a substitute transaction. Cadenza gains the $5 because she was able to sell the fabric—something she would not have been entitled to do in the absence of breach.

f. The Addition of Incidental and Consequential Damages

Consequential damages are more fully discussed in section 18.5 and incidental damages in section 18.12. However, it is helpful at this stage to show how they fit into the formulas that we have been working with. In short, incidental damages are expenses that the plaintiff incurs in handling the breach—the cost of taking whatever reasonable action is needed to protect and enforce the plaintiff's rights under the contract. They may include such expenses as the transaction costs of taking action to mitigate the effects of the breach and of entering into a substitute transaction. Consequential damages compensate the plaintiff for loss or injury suffered in other transactions that were dependent on this contract, or for loss or injury otherwise caused by the breach. For example, Cadenza La Scala, the dressmaker, becomes very busy during the period of the singing competition because so many of the competitors order dresses from her. To cope with the increase in demand she enters into a contract with Tex Tile, a highly skilled seamster, under which Tex agrees to work as her assistant for a month. Tex reneges at the last moment. Cadenza spends money advertising for another assistant, but she cannot find anyone with Tex's skills, so she settles for someone who is inexperienced and limited in capability. Because she does not have expert assistance, Cadenza cannot make as many dresses as she had expected and has to turn away several customers. The cost of trying to find a substitute is incidental damages, and the profit that she lost as a result of turning away the customers is consequential damages. If you look again at the formula suggested by Restatement, Second, §347 and set out at the beginning of this section, you will see that incidental and consequential damages are included in the "any other loss" category. That is:

Plaintiff's loss in value (direct damages)
+ any other loss (including incidental and consequential damages)
− any cost or loss avoided

Incidental and consequential damages must be distinguished from direct damages,[6] which are represented in that formula as "plaintiff's loss in value." (On the facts of this illustration, Cadenza has not suffered any direct damages, so her claim is solely for incidental and consequential damages.)

§18.4 AN OVERVIEW OF EXPECTATION DAMAGES UNDER UCC ARTICLE 2

§18.4.1 The Basic Principles

The discussion of expectation damages in section 18.3 covers both the common law and UCC Article 2, and includes illustrations concerning sales of goods. You are therefore already familiar with the pertinent Code provisions. Notwithstanding, it may be helpful to review the Article 2 provisions on expectation damages as a whole to show their organization, the symmetry between buyer's and seller's remedies, and their basis in common law principles.

The concept of expectation relief under Article 2 is essentially the same as that under the common law. Like the common law, it reserves the remedy of specific performance for special cases and treats damages as the primary remedy for breach. The award of damages is meant to achieve, as closely as possible, the economic position the plaintiff would have been in had there been no breach. This principle is strongly articulated in §1.305, which declares that UCC remedies "shall be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed." Article 2 provides statutory formulas for calculating compensation. It organizes them into seller's remedies for the buyer's breach (§§2.703-2.710) and buyer's remedies for the seller's breach (§§2.711-2.717). Although there is necessarily some variation between these two sets of remedies, they are largely mirror images of each other, providing approximately equivalent rights to buyers and sellers but taking into account the somewhat different remedial needs of each.

§18.4.2 The Seller's Remedies

Sections 2.706, 2.708, and 2.709 contain the core of the seller's expectation remedies. Section 2.709 is the seller's specific performance remedy for payment of the price of the goods. Like the common law, Article 2 sees specific enforcement of the contract as a limited and secondary remedy, available only when damages are inappropriate. Section 2.709 therefore allows the seller to claim the price of the goods only when the goods have been accepted by the buyer or they are incapable of being resold because they have been lost or damaged or are just not resalable.

The other two sections contain the primary remedies of the seller's expectation damages where the buyer breaches by failing to accept conforming goods tendered by the seller. Section 2.706 permits an aggrieved seller to enter a substitute transaction by reselling the goods and, provided that the resale is made in good faith and in a commercially reasonable manner, to recover the shortfall between the contract price and the resale price. Section 2.708(1) recognizes that damages may be based on a hypothetical resale as an alternative to actual resale. It allows the seller to calculate damages based on the difference between the contract price and the market price of the goods at the time and place at which delivery was to have been tendered under the contract. This may be used, for example, when the seller elects not to resell, or when the resale was not conducted reasonably, resulting in too low a resale price. Some, but not all, courts even allow it as an alternative when the seller has resold above the market price, so that the contract-market difference provides a more advantageous recovery.

When the remedy of contract-market damages does not give an adequate recovery[7] so that it is inappropriate to use the contract-market difference as a basis for measuring damages (such as cases in which the seller decides not to manufacture the goods following breach, or suffers a loss in volume of sales as explained in section 18.6.3), §2.708(2) permits recovery of the seller's gross profit plus reliance expenses, less allowance for payments or salvage received.

Nowhere in §2.706, 2.708, or 2.709 is any provision made for the seller to receive consequential damages.[8] The reason for not mentioning consequential damages in these sections is unclear. Some courts have held that even though Article 2 does not mention seller's consequential damages, it does not expressly disallow them, so they can be awarded if proved. Other courts have refused to award consequential damages to a seller on the grounds that their omission from the seller's remedy sections evinces legislative intent not to allow them.

§18.4.3 The Buyer's Remedies

The buyer's specific performance remedy is set out in §2.716. It, too, is a secondary remedy, available only when damages cannot adequately compensate because the goods are fairly regarded as unique under the circumstances of the case. In other situations in which the buyer has rejected nonconforming goods or the seller has failed to deliver any goods at all, the buyer is confined to substitutionary damages, based on an actual good faith and reasonable repurchase of the goods (cover) under §2.712 or a hypothetical repurchase under 2.713, calculated as the difference between the market price at the time the buyer learned of the breach and the contract price. The language identifying the buyer's hypothetical market is different from that set out for the seller in §2.708(1). Briefly stated, the seller's market price is measured in §2.708(1) at the time and place of tender, whereas §2.713 requires the buyer's damages to be measured at the place of tender, or in some cases, at the place to which goods are to be shipped. The time for measuring the buyer's damages is the time that the buyer learned of the breach. This has led to some difference in interpreting the proper time and place for determining market price where the buyer claims market-contract damages, which we will not go into here.

Article 2 prefers the cover-contract difference as the more realistic measure, but the buyer is permitted not to cover, and instead use the market price of the goods as a basis of recovery. The market standard is also used if the buyer did not act reasonably in covering, so that the cover price is excessive. As in the case of sellers, there is some controversy over whether a buyer who has covered at a price lower than the market may nevertheless elect to sue for damages based on the more advantageous market-contract difference.

In some cases, a buyer may not be able to make a substitute transaction and may suffer consequential damages as a result of the breach. If so, §§2.714 and 2.715 permit their recovery. (The nature of consequential damages and the prerequisites for their recovery is discussed in section 18.5.) Finally, when the seller has breached by delivering goods that are defective or not in conformity with what was promised under the contract, but the goods have been accepted by the buyer, damages based on an actual or hypothetical repurchase are not appropriate. Section 2.714 therefore measures damages for accepted goods based on the loss suffered by the buyer as a result of the deficiency in the goods. This principle ties in with the discussion of partial breach in Chapter 17.

§18.5 THE DISTINCTION BETWEEN DIRECT AND CONSEQUENTIAL DAMAGES

The previous examples have focused on damages that are a direct result of the breach. That is, they can be readily and easily attributed to the breach and are designed to compensate for the very performance that has been promised. Thus, for example, after Harmony breached her promise to coach Sara, Sara's cost of hiring a substitute trainer does no more than substitute for the performance of the contract itself. The same is true when Ken Tractor or Cadenza La Scala seek their outlay and expected profit in their construction or manufacturing contracts. These cases are all characterized by the fact that the award of damages goes no further than the confines of the contract itself to compensate for the breach. The payment of money is designed to give nothing more than the benefit of performance, whether in the form of the costs of a substitute or the lost gains under the contract. The payment of damages thus acts as a direct equivalent for the expected performance and thereby fully cures the disappointed expectation. For this reason, the compensation paid is called direct damages.

In some cases, however, it is not enough to award only these direct damages, because the breach has had more far-ranging consequences. Quite apart from any direct damages to compensate for disappointed expectations under the contract, the breach has caused further losses in other transactions or endeavors that were dependent on the contract or has resulted in some other injury, whether physical or economic. For example, recall that Harmony had undertaken to give Sara a series of voice training lessons in the week before the competition. In our first illustration, she reneged just a few days before the lessons were to begin, but Sara was able to find another teacher. What if no other teacher was available, so that Sara could not obtain the training? As a result of being deprived of coaching in the crucial period before the competition, she was not adequately prepared for it. A whole horde of voice experts are available to testify, based on meticulous scientific tests, that Sara has talent of almost superhuman dimensions, and she would have been able to sing circles around the other competitors had she received the week's intensive training. If this can indeed be shown, a mere award of any difference between the contract price and the higher market price of a substitute would not be enough to compensate her for the loss of her contractual expectations. Her loss consequent on the breach is far more serious and must take account of all the opportunities for fame and fortune that would have flowed from her success in the competition. These losses, consequent on the breach, are called consequential damages.

This example graphically portrays the difference between direct and consequential damages, but it also suggests some of the particular problems that a plaintiff must deal with to obtain consequential damages. Even if she has a bevy of experts to attest to her genius and the certainty of victory that would have followed proper training, Harmony may be able to summon an equivalent phalanx of experts who will conclude differently. Even if Sara succeeds in convincing the factfinder of the important role that training would have played in her success, she must also establish the probability that Harmony's breach was the only reason why she did not win, that Harmony should reasonably have understood that this consequence was likely, and that Sara could not herself have taken some reasonable action to prevent it. Finally, Sara would also have to make a credible showing of the actual harm she suffered—that is, the opportunities that she lost, and would have to be able to place a plausible money value on her injury. All these considerations are commonly referred to as limitations on her recovery, and they are discussed more fully in the next section.

In the above example, Sara's consequential damage (if it can be proved) results from the loss of the opportunity of making gains in transactions that are dependent on the contract. However, sometimes consequential damages arise from some physical or economic injury suffered as a result of the breach. For example, a homeowner contracts with a furnace repairer to fix her gas furnace. The repairer does an incompetent job, and the furnace explodes, injuring the homeowner and destroying part of her house. Direct damages (the cost of having the job done properly) would not be adequate compensation to the homeowner. However, consequential damages would be recoverable to compensate her for her physical injury and the destruction of her property caused by the repairer's breach of contract.

The above illustrations involve common law contracts. As indicated in section 18.4.3, the buyer of goods may also suffer consequential damages as a result of the seller's breach. Sections 2.712, 2.713, and 2.714 all recognize that a buyer may suffer consequential damages apart from the direct damages covered by those sections, and §2.715(2) describes consequential damages as including "any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably have been prevented by cover or otherwise." For example, say that the buyer operates a store that sells gift wrap, cards, and other such items. In July, she orders her annual stock of Christmas paper, boxes, ornaments, and cards from the seller, her major supplier, for delivery on November 1. On October 30, the seller repudiates that contract by notifying the buyer that it will not deliver the goods. The buyer tries to order substitute goods from other suppliers, but at that time all seasonal products have been sold to other stores so the buyer cannot cover. Direct damages, in the form of the difference between the cover price and the contract price, are therefore not available. The other form of direct damages—the market-contract difference—does not adequately compensate the buyer, who has lost profits as a result of the seller's breach. These lost profits are consequential damages that the buyer can claim under §2.715.[9] Like Sara, the buyer must establish the amount of these damages and must also prove that the seller reasonably should have contemplated that she would incur a loss of this kind as a result of the breach and that she was unable to prevent the loss.

Although Article 2 expressly provides for a buyer's consequential damages, it says nothing of a seller's right to claim them. In addition, §1.305(a) states that consequential damages are not available unless provided for in the UCC or another rule of law. It is possible that the drafters of the UCC did not mention sellers' consequential damages simply because they did not think that a seller would ever be likely to have consequential damages. Although sellers do not commonly suffer consequential damages, there have been cases in which a seller has been able to show that it suffered damages as a consequence of a buyer's breach. However, some courts have declined to allow those damages on the basis that a seller is not entitled to them under Article 2.

§18.6 LIMITATIONS ON EXPECTATION RECOVERY

§18.6.1 The Nature and Goals of the Limitations

As just intimated, a number of factors, often referred to as limitations on expectation damages, must be taken into account in reaching a final decision on the extent of the proper monetary award. Although called limitations, these factors are not, for the most part, external checks on damages but are simply an expression of principles inherent in the goal of compensating for the loss of reasonable expectations. Each of the limitations is covered in detail below. This section just introduces them and sketches the overall values and practical considerations that they are intended to serve: The limitation of foreseeability ensures that the extent and scope of damages are consistent with what was reasonably contemplated by the parties at the time of contracting. The requirement of mitigation protects the breaching party from the unreasonable failure of the victim of the breach to control or curtail the harm resulting from the breach. The requirement of causation restricts the damages to losses that can be causally linked to the breach. The requirement of reasonable certainty places the burden on the victim of breach to prove, on the preponderance of the evidence, both the fact and the extent of loss. Finally, the doctrine of unfair forfeiture allows the court to exercise discretion to temper an award of damages that would otherwise be available on a strict application of the rules, if the award would unfairly harm the defendant and result in a windfall to the plaintiff.

§18.6.2 Foreseeability

a. The Concept of Foreseeability

An event or consequence is foreseeable when a reasonable person would realize the likelihood of its occurrence. Foreseeability is thus an objective concept, concerned not with what a particular person actually did foresee, but what she would have foreseen had she reasonably contemplated the course of likely future events. Applied in the context of liability for breach of contract, damages are foreseeable when, at the time of making the contract, the party who ultimately breached reasonably should have realized that those damages would be a likely consequence of the breach.

The reasonable foresight of probable consequences depends on the extent of information available to a party that would alert her, at the time of contracting, to the probable result of her breach. The fundamental rationale of the foreseeability principle is that a breaching party should not be held liable for a loss that she could not reasonably have anticipated as a consequence of breach when she entered the contract. The time of contracting, and not the time of breach, must necessarily be the point at which foreseeability is gauged.

The foreseeability principle is regarded as having been firmly established in the common law by the English case, *Hadley v. Baxendale*, 156 Eng. Rep. 145 (Exchequer 1864). The owners of a mill delivered a broken mill-shaft to a carrier for shipment to the manufacturer so that it could be used as a model for a new one. There was a delay in the shipment. Because this was the mill's only shaft, the delay idled the mill for longer than necessary. The owners sued the carrier for damages based on the profit that they lost when the mill could not operate during the period of delay. Although the court acknowledged that the delay did in fact directly result in the loss of profits, it declined to award those lost profits as damages. The court found the carrier not to be accountable for that loss because it was not told that this was the only shaft and had no way of knowing that a delay would cause the mill to lie idle.[10] The court enunciated the rule of foreseeability that is still current today and is reflected in modern formulations in language that deviates little from that used in the case: It held that damages for breach may only be recoverable if one of two conditions is satisfied: Either the loss must be one that may fairly and reasonably be considered to arise naturally—in the ordinary course of things—from the breach, or it must be one that may reasonably be supposed to have been contemplated by the parties at the time of contract as a reasonable consequence of breach. (Although *Hadley* refers to the parties' contemplation, we are, of course, principally interested in the reasonable contemplation of the party who breached, measured objectively, not by what he actually knew and realized, but by what he reasonably should have known and realized.) In essence, the rule in *Hadley*, adopted in both Restatement, Second, §351 and UCC §2.715, treats damages as foreseeable in two situations:

1. The breaching party should reasonably have expected such damages to be a likely consequence of breach in the ordinary course of events, or
2. If, outside the ordinary course of events, the breaching party had reason to know of special circumstances that could reasonably give rise to such damages.

For most modern courts, reasonable contemplation of liability for loss is satisfied if it is established that the breaching party had reason to know of the probable consequences of breach, either because they would arise in the ordinary course, or because the breaching party had reason to know of special circumstances that could give rise to them. A more stringent test, known as the "tacit agreement" test, was articulated by Justice Holmes in *Globe Refining Co. v. Landa Cotton Oil Co.*, 190 U.S. 540 (1903). This stricter test of foreseeability requires not merely that the probable consequences of the breach were reasonably foreseeable by the breaching party but also that, under all the circumstances of the contract (such as the nature of the contract and the extent of risk that was likely assumed in light of the economic value earned by the breacher under the contract), it is fair to conclude that the breacher tacitly assumed the risk of liability for those damages. That is, had the likely consequences of breach been brought home to him at the time of contracting, he would likely have agreed to assume liability for them. The tacit agreement test is generally regarded as too restrictive by modern courts, and it is expressly rejected by Restatement, Second, §351, Comment *a* and UCC §2.715, Comment 2. Therefore, for most modern courts, the focus of reasonable contemplation is simply on the relationship between the information available to the breacher and the loss.

b. Foreseeability in Relation to Direct Damages

Foreseeability is not usually an issue in a claim for direct damages. When a party enters a contract, she understands or should understand that if she breaches, the other party will suffer the loss of whatever benefit she promised under the contract, whether that benefit is a profit or the acquisition of services or property on advantageous terms. The concept of foreseeability does not require that the breaching party had to foresee the amount or exact nature of the loss or the precise way in which the other party would elect to attain his expectation, but merely that she reasonably understands that if she breaches, the other party will lose whatever value was reasonably expected.

c. Foreseeability in Relation to Consequential Damages

As discussed in section 18.5, a breach of contract could result in consequential damages if it causes losses beyond the actual deprivation of the contractual performance. This is the focus of the principle of foreseeability. It confines liability for consequential damages to those losses that a party reasonably should have contemplated as a probable result of her breach, based on information to which she had access at the time of contracting. Restatement, Second, §351 and UCC §2.715 break consequential damages into two categories: General damages are those that are foreseeable as a probable result of the breach in the ordinary course of events. Special damages are those arising out of special circumstances that the breaching party would not have reason to know unless informed of them.

i. General Consequential Damages

Damages that arise naturally, in the ordinary course, are called "general damages." They include not only all easily imaginable direct damages but also those consequential damages that should be obvious to the breacher without any special or particular knowledge of the other party's circumstances or affairs, because such a loss would be a normal and well-accepted likelihood of the breach of a contract of this kind. Of course, what is generally understood as a likely consequence of breach is decided not in the abstract but in light of the circumstances of the case and the contracting environment.

For example, the roof of a home is damaged by a falling branch, which leaves a gaping hole in the roof. The homeowner enters into a contract with a roofing contractor to make an emergency repair on the roof on the very day of the damage. The homeowner makes it clear to the roofer that the repair is urgent and must be performed on that day, and the roofer expressly agrees to come to the owner's house within three hours to do the repair. Three hours later, the roofer calls the owner and tells him that he is too busy and cannot do the roof repair for several weeks. This is a breach of the contract. The roofer must surely contemplate the probability of direct damages—that the owner will hire a substitute contractor and will suffer direct damages if the cost of the substitute is higher than the contract price. However, the breaching roofer must also reasonably realize that the owner may not be able to get someone else out immediately and that if it rains, there could be water damage to the interior of the house under the hole in the broken roof. Any damage to the interior is consequential—it is not a cost of achieving the promised performance but a loss resulting as a consequence of the breach. This consequential damage would fall into the first category identified in *Hadley* because the possibility of rain damage is something that may reasonably be considered as arising naturally in the normal course of human experience. One needs no special information about the homeowner's affairs to recognize this risk of breach.

ii. Special Consequential Damages

The second category, called "special damages," can be illustrated by embellishing the facts of the last example. Say that the area beneath the broken roof happened to contain an expensive piece of electronic equipment that is affixed to the floor and cannot be moved or otherwise protected. Unless the roofer was told or otherwise had reason to know about the equipment at the time that he made the contract, it would not be fair to hold him liable for damage to it because he had no basis for expecting this loss. Had he known about it, he may well have declined the contract or he may have decided to undertake it only if the owner paid a higher price to cover the cost of extra precautions or as a premium for the assumption of the greater risk of liability. By not giving the roofer the information, the homeowner deprives him of the means to make a rational decision on risk or to take additional steps to minimize the chance of breach. The owner therefore should not be able to hold him accountable for the unusual loss. Not only does the rule protect the roofer from surprise liability, but the fact that the rule exists is likely to be an incentive to a party in the owner's position to provide adequate information, which is likely to increase the efficiency of transacting and may even lessen the chance of breach. The foreseeability principle can therefore be justified as economically efficient as well as fair.

The concept of reasonable contemplation is central to the foreseeability of special damages, but its scope and meaning are elusive. To begin with, recognize that it does not require that a reasonable person in the breacher's position would have foreseen the exact loss with great precision and specificity. All that is required is that a loss of that nature and approximate extent could be conceived of as a probability. In requiring the contemplated loss to be probable, rather than just possible, the law does not cover every possibly imagined serendipitous or outlandish consequence, but it does cover more than those outcomes that are obvious inevitabilities. This means that it can be a subtle exercise to decide on the strength of the link between the information available to the breacher and her reasonable accountability for the ultimate consequences of her breach.

iii. The Relationship Between the Nature of the Exchange Under the Contract and the Loss

Where the consequential damages arising from a breach are very large and the consideration earned by the breacher under the contract is small, there could be a question of whether the breaching party should be liable for consequential damages so disproportionate to what it earned under the contract. This can be illustrated by facts based on *Hadley*. Say that the carrier charged $100 for transporting the broken mill shaft to the manufacturer for repair. The miller did inform the carrier that the mill could not operate until the shaft was repaired, so that the carrier did foresee the probability of loss of profits if it breached the contract. As a result of its breach, the mill was idle for several days, resulting in lost profits of $10,000. The carrier argues that because its charge under the contract was only $100, it could not possibly have assumed the risk of liability for $10,000. The old "tacit agreement" test would accommodate this argument because the value of the consideration earned by the breacher would be relevant to determine what liability he tacitly agreed to assume. However, because most modern courts do not follow that test, a party could be held to have reasonably contemplated great liability despite the modest value of what she was to gain from the contract. In these circumstances a court may elect to use its equitable power, recognized by Restatement, Second, §351(3), to limit foreseeable damages that are disproportionate to the compensation earned by the breacher. A more reliable way of protecting against damages disproportionate to earnings under the contract is to include in the contract a term limiting or excluding liability for consequential damages. (Damage limitation provisions are discussed in section 18.11.3.)

§18.6.3 Mitigation

a. The Purpose and Policy of Mitigation

In most cases, a rational party, faced with a breach by the other, will naturally take whatever action is necessary to avoid or minimize loss. Unless the victim of a breach is particularly stupid, litigious, or spiteful, her self-interest will propel her in the direction of keeping her loss as small as possible, rather than aggravating it in the hope that she will ultimately be able to recover it from the breaching party. This means that it seldom happens that the plaintiff deliberately and maliciously sets out to incur extra damages for the purpose of increasing the amount of her claim against the defendant. More commonly, the defendant's allegation that the plaintiff failed to mitigate is likely to turn on the question of whether the plaintiff's response to the breach was an unreasonable or poor judgment that aggravated damages.

The basic principle of mitigation is that if the plaintiff, through bad faith or unreasonable action or inaction has failed to prevent or has aggravated her damages, the defendant is not held responsible for the increase in loss caused by the plaintiff. This is often described as the plaintiff's duty to mitigate damages. Of course, this is not a duty in the normal sense, because the plaintiff owes it to no one but herself to keep her losses down. But if she fails in that duty to safeguard her own economic welfare, fairness dictates that she must be left with the added loss and the defendant should not be called on to pay it. It may be obvious from what has just been said that a failure to mitigate damages does not deprive the plaintiff of all relief but affects recovery only to the extent that the damages were increased as a result of the plaintiff's conduct. The plaintiff is therefore still entitled to recover those damages that she could not have avoided by good faith or reasonable conduct.

It must be stressed that the question is not merely whether the plaintiff's response to the breach turned out, with hindsight, to be a wrong judgment that failed to contain or worsened the harm. Nor is it enough that a different response would have been preferable. The words "bad faith" and "unreasonable" indicate that there must be some element of fault on the plaintiff's part. It must be apparent that the plaintiff's behavior in reacting to the breach was dishonest, opportunistic, or vindictive or that it so deviated from what would be expected that it failed to conform to community standards of rationality. The law recognizes that the defendant has breached the contract, leaving the plaintiff in the unhappy position of having to salvage the benefit of her bargain. For this reason, the plaintiff, herself the victim of the defendant's wrong, should be given some leeway when her response is judged. It must be clear, under all the circumstances, that the plaintiff's reaction to the breach is sufficiently improper that it would be wrong to make the defendant bear the increased loss. Restatement, Second, §350 expresses this approach by stating that losses are not recoverable if the plaintiff could have avoided them without "undue risk, burden or humiliation," but the plaintiff should not be precluded from recovery to the extent that she made "reasonable but unsuccessful efforts to avoid harm."

The general principles of mitigation recognized in common law are applicable to UCC Article 2 and are reflected throughout its remedies provisions. Sections 2.706 and 2.712 require an aggrieved seller or buyer to act reasonably, in good faith, and within a reasonable time when making a substitute transaction; §2.715 bars a buyer from obtaining consequential damages that could have been prevented by cover or otherwise; §2.704(2) reflects the seller's duty to mitigate in deciding whether to complete the manufacture of specially ordered goods; and §2.709 requires the seller to make reasonable attempts at resale before claiming the price of the goods from the buyer.

The principle of mitigation makes perfect sense on its own merits because the defendant should not be accountable to the extent that the consequences of breach are exaggerated by the plaintiff's fault, and because a rule that encourages the plaintiff to control loss is efficient and sensible. In addition, however, it is congruent with two other limitation principles: A loss caused by the plaintiff's improper actions is not reasonably foreseeable, and the plaintiff's conduct breaks the chain of causation between the breach and the loss.

b. The Reasonableness Test for Determining Whether the Plaintiff Violated the Duty to Mitigate

As stated earlier, unless bad faith is evident, the plaintiff's accountability for aggravated loss depends on the reasonableness of her response to breach. As always, reasonableness is a factual matter. The plaintiff's action or failure to act must be evaluated by an objective standard under all the circumstances of the case: Was it reasonable for a person in the plaintiff's position to have responded to the breach as she did at the time that the breach occurred? This inquiry takes into account a whole range of factual questions such as what the plaintiff did or did not do; what choices were available to her; what risks, hardships, or inconveniences were involved in each choice; what her motivation was in choosing as she did; how much time she had available to respond; and how quickly she took action. All of these facts are looked at with a sympathetic eye on the plaintiff. As the breach compelled her to take action to safeguard her interests, courts are inclined to respect her judgment if it had an honest and rational basis, even if the defendant can point to a different response that may have been more effective in fully or partially preventing the loss. Because the plaintiff is the wronged party, she is not expected to take heroic or exhaustive action to keep damages at a minimum. The defendant cannot complain of a failure to mitigate if the action required to reduce loss would have been unduly burdensome, humiliating, or risky to the plaintiff. Similarly, the plaintiff cannot be expected to explore every conceivable possibility of avoiding loss or to try methods that reasonably appear to be futile.

Although the plaintiff has the burden of proving her damages, once she has established loss, the defendant has the burden of proving that the plaintiff failed to mitigate that loss. This is because the defendant's assertion that the plaintiff failed to mitigate damages is treated as an affirmative defense relating to the extent of liability. The defendant must show what reasonable actions the plaintiff should have taken to curtail her loss, and that those actions would have reduced damages by a specific amount. Once it is established that the plaintiff's reaction to the breach unjustifiably increased her loss, the next task is to calculate what the damages would have been had the proper response been made. This is also a factual issue, involving an inquiry into the causal link between the plaintiff's conduct and the loss.[11]

c. The Substitute Transaction as Mitigation

The most obvious form of mitigation is the substitute transaction. We saw an example of this right at the beginning of this chapter when, a few days before the voice training was to begin, Harmony repudiated her contract with Sara to provide the lessons for a fee of $1,500. Sara hired another voice coach for $1,800 and claimed the $300 difference as expectation damages. The decision to hire another coach is itself an act of mitigation in that it prevented any consequential loss that Sara may have suffered by entering the competition without the training. (The fact that such a consequential loss may have been speculative and very difficult to prove increases Sara's incentive to avoid it.)

Although the hiring of the substitute coach prevented more serious consequential losses, the choice of the new coach is still subject to a standard of reasonableness. Sara must make reasonable and good faith efforts to find an equivalent coach at the most economic price. This does not mean that she has to use the cheapest substitute, or that she has to make exhaustive enquiries to find the best bargain available. However, she will not recover the full cost of the substitute if, by the exercise of reasonable diligence, she would have been able to find an adequate substitute at a lower price. Sometimes, even with conscientious effort, the only substitute a victim can find is better than the contract performance. If this is the closest reasonable replacement for the performance, the court is likely to award the cost of it to the victim, even though it might give her more than her expectation under the contract. This may be the fairest resolution given that the breacher caused the problem and the victim has no choice but to take the more valuable substitute to approximate the performance promised by the breacher. For example, in *Handicapped Children's Education Board v. Lukaszewski*, 332 N.W.2d 774 (Wis. 1983), the defendant, a speech and language therapist, breached her employment contract by resigning. The Board sought to replace her. The only applicant for the position was more senior and had to be paid a higher salary in accordance with union rates. The Board hired that applicant and sued the defendant for the difference between what it would have paid the defendant under the contract and what it had to pay her replacement. The defendant argued that she should not be liable for this additional cost because the Board received the benefit of a more experienced therapist for the higher salary. The court rejected this argument. The Board did not need or desire a more experienced therapist, but the defendant's breach left it with no choice but to take the only available substitute.

In Sara's case, the issue of a reasonable substitute comes up in connection with her claim for damages for its added cost. However, the issue also arises when the breach releases a plaintiff from performance, so that a substitute transaction becomes available to reduce the plaintiff's loss. For example, say that a few days before the voice training lessons were to begin, Sara repudiated the contract. Harmony now finds that she has 28 hours of free time in which she will not be gainfully employed. If she does nothing about this, she will lose her full profit from the transaction—the contract price of $1,500 less any costs. However, if she is able to take another student or otherwise use this time to generate income, she will reduce or possibly eliminate completely her loss from Sara's breach. It therefore stands to reason that if Harmony sues Sara for her lost profit, she will have to deduct whatever she earned in the time freed by Sara's breach. If she failed to use the time gainfully at all, Sara may be able to reduce her liability for Harmony's loss by showing that Harmony failed to mitigate her damages by productively redeploying this time.

Assume that as soon as Sara repudiated, Harmony put up notices at local schools and colleges advertising her availability, and she also called all the people she knew who may have referrals. However, no one expressed interest in lessons for the week in question. Harmony also saw an advertisement seeking temporary, part-time help as a sales assistant in a music store. She did not pursue this possible opportunity of part-time employment. When she sues Sara for her full profit under the contract, two issues could be raised: First, were her efforts in seeking other students reasonable under the circumstances? It sounds as if she did everything reasonably possible considering the short time available to fill the slot left empty by Sara's breach. Second, should she have made an effort to recoup at least some of her loss by seeking the advertised temporary job at the music store? This is a harder question, because working in a music store is only tangentially related to her career as a voice coach, and it sounds like inferior employment that does not advance her career and could even damage her standing as a teacher. A victim of a breach is allowed reasonable discretion in declining to pursue unsuitable alternatives, and it is arguably reasonable for her to decide not to consider this prospect of generating some income to offset her loss. (Of course, as noted at the end of this section, if she did take the job at the music store, and worked there during the times that had been allocated to coaching Sara, she would have to deduct those earnings from her claim for damages.)

Parker v. Twentieth Century-Fox Film Corp., 474 P.2d 689 (Cal. 1970), is an old favorite that involved the issue of whether the victim of a breach acted reasonably in refusing to mitigate her loss by entering into an available substitute transaction. The actress Shirley MacLaine (Parker) entered into a contract with the studio to star in a musical called *Bloomer Girl* for a fee of $750,000. The studio canceled the production, thereby breaching the contract. As a substitute, the studio offered MacLaine the leading role in another movie, a western to be filmed in Australia. MacLaine rejected the substitute and sued for the full amount of the fee for *Bloomer Girl*. The studio argued that she was not entitled to any damages because she could have avoided all loss by taking the other role offered. The court disagreed and granted summary judgment to MacLaine for her full fee. The court found that the role in the western was both different from and inferior to the lead in *Bloomer Girl* because it was a poorer vehicle for her talents and the substitute contract eliminated her rights to approve personnel and screenplay. Although the victim of a breach must take reasonable steps to mitigate her loss, she is not required to suffer undue burden or prejudice. In the employment context, the court must be particularly solicitous of the impact that the offered substitute might have on the plaintiff's career goals, professional development, and dignity. (A dissenting justice was not persuaded that the role in the western was inferior. He felt that the case should go to trial, and should not be disposed of by summary judgment.) By contrast, in *Fair v. Red Lion Inn*, 943 P.2d 431 (Colo. 1997), an employee refused her ex-employer's offer to reinstate her after she had been wrongfully dismissed. The employee sued for damages for breach of the employment contract and claimed that she was not obliged to mitigate her loss by accepting reinstatement because she feared that the employer was not sincere and would just terminate her again later. The court conceded that it was natural for her to mistrust the employer, but she could not offer any evidence to support her concerns. She therefore could not claim damages that would have been avoided had she accepted the employer's offer of mitigation. (Note that in both these cases, the plaintiff's best prospect of mitigation was to enter into a substitute transaction with the breaching party. As *Fair* suggests, the victim may find it quite unpalatable to accept mitigation from the very person who breached the contract, but this on its own is not grounds enough to refuse the substitute transaction.)

Although the victim of the breach is not required to mitigate by entering into a substitute contract that is unduly burdensome, humiliating, or harmful to her long-term interests, if she does in fact take the substitute, her earnings must be deducted from her damages. For example, in *Marshall School District v. Hill*, 939 S.W.2d 319 (Ark. App. 1997), the school district wrongfully dismissed Hill, a teacher and football coach. He found work in a shirt factory for a while before he secured employment as a teacher in another school district. The court held that because these earnings, including the earnings from his factory work, were from substitute transactions that he actually entered following his dismissal, they should be offset against his damages.

d. Post-breach Transactions That Are Not Appropriately Treated as Substitutes: The "Lost Volume" Situation

In the last example, Sara repudiated the contract for voice training a few days before the lessons were to begin. Assume that the day after Sara repudiated, Harmony took on a new student. This student would clearly be a substitute for Sara if Harmony was fully booked, and could not have taken on a new student had Sara not terminated the contract. However, if Harmony was not fully booked, and she could have accepted this student even if Sara had not breached, the new student is not a substitute for Sara. Therefore, one should not automatically assume that a similar transaction after the breach must be a substitute for the broken contract. It should only be so treated if it is clear that the plaintiff would not or could not have entered it in the absence of breach. Failure to maintain this distinction carefully could lead to an unfair and unwarranted reduction of the plaintiff's recovery by offsetting the proceeds of an entirely independent transaction.

Consider a second illustration, based on a sale of goods: A homeowner sells her used fridge for $200, but the buyer breaches the contract by failing to take delivery and pay for it. The seller then sells it to someone else for the same price. Obviously, the second sale is a substitute because the seller had only that one fridge to sell. However, if the seller was not a homeowner trying to sell a single fridge, but a huge appliance store with a whole warehouse of fridges of this exact make and model, the resale of the fridge to the second buyer is not so clearly a substitute transaction. Because the seller has a stock of identical products, it had another one to sell to the second buyer even had the first buyer not breached. It could therefore have sold two fridges instead of one, and the breach has the effect of reducing its volume of sales. If the seller can establish such a lost volume situation, the second sale is not a substitute, its proceeds should not be treated as reducing the loss from the breach, and the seller is entitled to recover its full profit expected under the breached transaction. In a sale of goods, §2.708(2) caters for lost volume. It provides in essence that when the usual measure of damages—the difference between the contract price and the market price on resale—is inadequate to fully compensate the seller, the seller's lost profit on the sale is the appropriate measure.

Rodriguez v. Learjet, Inc., 24 Kan. App. 2d 461 (1997), illustrates the application of §2.708(2). After the buyer repudiated a contract for the purchase of a jet the seller sold it to someone else. The court identified three elements that a seller must establish to be treated as a lost-volume seller and found that the seller had satisfied all three: It had shown that its plant was operating at 60 percent capacity, so it could have made and sold more planes; it proved that the additional sale would have been profitable; and it established that it probably would have made the subsequent sale even if the buyer had not breached the contract. One of the elements specified in *Rodriguez* is that the seller can show that the additional sale would have been profitable. Some commentators have argued that this should be a crucial element because additional sales may not continue to generate profits equivalent to the profit on the sale in issue. Factors such as increases in the seller's marginal costs and competition in the market from used goods may reduce and ultimately eliminate profits from successive sales. Notwithstanding, many courts do not place such a rigorous burden on the seller, who is, after all, the injured party, and who is only required to prove loss on a preponderance of the evidence. In *National Controls, Inc. v. Commodore Business Machines, Inc.*, 163 Cal. App. 3d 688 (1985), the court noted that profits might diminish as more sales are made. However, it observed that most courts do not require the seller to produce economic analysis to refute this possibility. It held that the seller had made out a sufficient case by showing merely that it had unused capacity and could have produced more units than it was able to sell.

The language of §2.708(2) is confusing because it provides that in calculating damages for lost profit, "due credit" must be given for "proceeds of resale." Taken literally, this language would eliminate the possibility of ever claiming lost profits if the seller resells the goods, even where the seller can show that the breach reduced its volume of sales. *National Controls*, adopting the approach of most courts, held that this part of the formula does not apply in a lost volume situation where the resale of the goods should not be seen as a substitute transaction and proceeds of the sale should not therefore be credited.

§18.6.4 Causation

The concept of causation is not as prominent in contract law as it is in tort because it is usually more self-evident and its function can largely be accommodated within the principles of foreseeability, mitigation, and certainty. It is therefore not given much separate attention by courts and commentators. Nevertheless, it is worth articulating as a distinct limitation on relief. A breaching party cannot be accountable for loss that was not caused by her breach. There must be a link between the breach and the loss. Causation is not usually an issue when direct damages are concerned. Unless the plaintiff has broken the chain of causation by aggravating damages, there is invariably a clear causal link between the breach and the loss of the contractual bargain. However, consequential damages are by definition more remotely connected to the breach, and when they are claimed, it must be established that they were indeed a consequence of the breach.

To illustrate, consider again one of the variations of the example concerning Harmony's breach of her contract to give voice training lessons to Sara: Harmony reneged on the contract just before the lessons were to begin, and Sara could not find a replacement teacher, so she had no choice but to sing in the competition without having had any coaching in the prior week. She lost the competition and sued Harmony for a huge amount of damages to compensate her for the loss of a career as a singing star. The theory of her suit was that Harmony's breach prevented her from winning and deprived her of the career opportunities that would have resulted. It does not take much imagination to realize that she would have great difficulty in establishing a cause and effect between the breach and her alleged loss. She may not be able to show a probable link between her failure to win and the lack of coaching because there are too many variables that could have intervened: She may not have been as talented as her competitors, she may have had a bad night, or the judges may have been wrong. Even if she could show a strong likelihood of success in the competition, she cannot go on to show that she would have had opportunities as a result, or that she would have acted successfully in pursuing them.

As you will readily recognize, some of the problems that Sara faces in proving her case may be described in terms of mitigation (did she make reasonable efforts to prevent or reduce the negative consequences of the breach?), or foreseeability (could Harmony have reasonably contemplated this huge loss?), or reasonable certainty (can Sara establish the fact and extent of loss?). Nevertheless, the question of causation is also present in the inquiry, and it is a useful adjunct to the other limitations in analyzing the issue of liability and justifying the result.

§18.6.5 Reasonable Certainty

As the party seeking to enforce the contract, the plaintiff bears the burden of proving her loss. If she is unable to show on the preponderance of the evidence the fact and extent of her loss, she will not be able to recover damages. The limitation of reasonable certainty is really nothing more than the embodiment of this principle—the evidence must be sufficient to persuade the factfinder that the loss is more likely to have occurred than not, and must give the factfinder enough basis for calculating a monetary award. As this suggests, reasonable certainty involves two inquiries: The threshold question is whether the plaintiff has proved injury. If injury is shown, the next question is whether the plaintiff has provided sufficient evidence to enable the factfinder to determine the amount of the loss.

As a general rule, the more clearly the plaintiff can demonstrate the first element (the fact that some injury was suffered), the greater effort the factfinder (court or jury) will make to come up with some kind of compensation figure. This is because it has now become clear that the plaintiff has indeed suffered some loss as a result of the defendant's wrongful violation of her rights, and the court should strive, insofar as possible, to come up with a figure to compensate for the loss. Of course, the plaintiff cannot get damages if she can present no plausible and relevant evidence of the amount of her loss, but if some helpful evidence is available, the factfinder will do the best it can to fix damages in some justifiable amount. This approach is reflected in Restatement, Second, §352, Comment *a*, which notes that although damages cannot be recovered for loss beyond the amount established with reasonable certainty, the policy of holding the breacher accountable for her wrongful act requires that doubts should generally be resolved against her once it is established that a significant injury has occurred. Therefore, the determination of damages is an approximation, not an exercise in mathematical precision. UCC §1.305, Comment 1, expresses a similar sentiment.

Because the injured party has the burden of proving both the fact and extent of loss, problems of certainty may affect damages of all kinds, whether direct or consequential. However, consequential damages usually present the greatest difficulties in proof. We first address reasonable certainty in relation to direct damages, and then in relation to consequential damages. Finally, we examine the particular problem of reasonable certainty where the injured party's loss arises from a new business or venture.

a. Direct Damages

Direct damages may be difficult to prove, for example, when the plaintiff seeks his expected profit from the contract, but cannot prove what that profit would have been. Say that an engineering firm enters a contract with a paper mill to design and manufacture an innovative system for the safe disposal of chemical wastes. The contract price for the system is $2 million. Before work begins, the mill reneges on the contract. The engineering firm's direct damages are its lost profits on the job, which must be established by deducting its expected costs from the contract price. However, the system would have been so revolutionary that the engineering firm has no reliable evidence of what its costs would have been. If it cannot establish those prospective costs with reasonable certainty, it will not be able to show that it expected a profit from the contract and will not recover any direct damages. Of course, if the engineering firm had done its planning properly before quoting a price for the work, it would have made a cost projection that, if it appears reasonably accurate and reliable, would likely be sufficient evidence to establish loss on the preponderance of the evidence. *Benchmark Health Care Center, Inc. v. Cain*, 912 So. 2d 175 (Miss. App. 2005), illustrates a common judicial approach to the proof of direct lost profit damages.

Benchmark wrongfully terminated a contract under which Cain was to provide rehabilitation therapy services for Benchmark for one year. Cain sued Benchmark for unpaid amounts due for services that had been rendered prior to termination and also claimed the profit that it would have made for the remainder of the term of the contract had Benchmark not canceled it. Benchmark challenged the jury's award of lost profit damages on the grounds that Cain had not proved lost profits on the preponderance of the evidence. The court upheld the jury award. The court noted that once the fact of loss has been shown, the plaintiff need not prove the amount of loss exactly or accurately. It is enough that the evidence allows the factfinder to make a fair and reasonable estimate of loss. The amount of probable lost profits over the remainder of the contract term was estimated by Cain's accountant, based on a projection from profits that Cain had made in the months prior to termination. The court said that while a future estimate necessarily involves some degree of speculation, the accountant documented and explained his methodology and his estimate was realistic.

b. Consequential Damages

Although direct damages can present problems of reasonable certainty, difficulty of proof is most commonly encountered when consequential damages are in issue. Sara's alleged loss of career opportunities, raised in the context of causation, is an extreme example of this. Not only would she have trouble showing a causal link between her claimed loss and Harmony's breach of the voice training contract, but she would also have great difficulty in establishing the fact and amount of that loss. Some courts may regard those difficulties as insuperable. Others may be willing, upon being satisfied that the breach did remove all chance of her winning the competition, to allow the jury to place a value on her chance of winning.

Sara's claim is plagued with particularly troublesome issues of uncertainty. Two cases further illustrate the problem of lack of reasonable certainty where consequential damages are claimed. In *ESPN v. Office of the Commissioner of Baseball*, 76 F. Supp. 2d 416 (S.D.N.Y. 1999), the court dismissed the damages claim of the Commissioner as too speculative. ESPN breached its contract with major league baseball when it preempted games scheduled for Sunday night broadcast in favor of NFL games. The baseball commissioner claimed that as a result of this breach, the league had suffered the loss of television exposure and the associated prestige as well as opportunities for promotions and sponsorships. The problem was that the commissioner could not offer any evidence of how much the league lost. The court said that where it is clear that a breach victim has suffered damages, the court will do what it can to make an award. However, it must have some foundation for making a reasonable estimate of the loss and cannot construct a figure out of the air to compensate for speculative or intangible loss. In *Central America Health Sciences University v. Norouzian,* 236 S.W.3d 69 (Mo. App. 2007), *aff'd* 241 S.W.3d 255 (Mo. App. 2008), the court overturned the trial court's award of consequential damages to a medical student. The student had completed his medical studies at the medical school, but the school refused to grant him a diploma on the grounds that he had not fully paid his tuition. The amount of tuition was in dispute, and the student established at trial that the university was not justified in its claim and that its withholding of the diploma was a breach of contract. Because the student did not have the diploma, the start of his career as a doctor was delayed by about three years, and he claimed loss of income as a result. The trial court awarded him damages of about $400,000, but this award was overturned on appeal as too speculative—the student could not show that had he been given his diploma on time, he would have passed the medical boards and been hired by a hospital as a resident. The court said that his anticipated salary was subject to contingencies that made his claim too uncertain.

Many cases do not present such insurmountable difficulties of proof, and the plaintiff is able to provide enough evidence of the fact and quantum of loss to enable the trier of fact to make a consequential damages award. For example, in *Marvin Lumber and Cedar Co. v. PPG Industries, Inc.*, 401 F.3d 901 (8th Cir. 2005), PPG, a seller of wood preservative, breached its contract with Marvin by delivering preservative that did not work properly. As a result of the defective preservative, Marvin's products rotted, causing it problems with its customers and damaging its business. Marvin sued PPG for damages, including lost profits, and the jury awarded damages for lost profits. The court of appeals upheld the award. The court stated the general principle that although purely speculative and conjectural damages will not be awarded, the plaintiff does not have to prove loss with exactitude. The evidence of lost profits in this case was the testimony of Marvin executives, based on its financial records, which showed that its profits had suffered since the problems with the wood preservative and that they would likely remain flat.

The court held that this was sufficient evidence to support the jury award. Marvin had also claimed damages for loss of goodwill, which relates to the diminished value of the business and is distinct from lost profits. The court overturned the jury award of these damages because it found that the evidence of lost goodwill was conjectural and the loss was incapable of being quantified. In *Bollea v. World Championship Wrestling, Inc.*, 610 S.E.2d 92 (Ga. App. 2005), Bollea, professionally known as Hulk Hogan, sued WCW for damages for breach of contract. He claimed that WCW violated the terms of their contract by not making him the featured wrestler at a pay-per-view event entitled "Bash at the Beach." He alleged that as a result he had suffered significant consequential damages arising from lost bookings and reduced income from merchandising and promotions. WCW applied for summary judgment, denying that it breached the contract and arguing that any lost profits were too speculative. The court refused summary judgment and allowed Bollea to proceed to trial. It noted that he was an established wrestler with a long history of past earnings and profits. He therefore could succeed in showing lost profits with sufficient certainty to permit a jury to calculate his damages.

c. New Businesses or Ventures

Both *Marvin* and *Bollea* involved plaintiffs with established businesses and a track record of past earnings that would allow them to make projections of loss as a result of the breach. Where the defendant's breach precludes the plaintiff from making expected profits from a new business, this track record is absent and the plaintiff's prospect of proving lost profit is weaker. Some courts (particularly in older cases) are hostile to a claim of lost profits where a business is new and untested, and treat evidence of potential profit as too speculative. However, the better view, more commonly found in modern cases, is to evaluate each claim on its facts to decide if there is enough information to provide a reasonable basis for determining the fact and extent of likely loss.

Blinds To Go (U.S.), Inc. v. Times Plaza Development, L.P., 931 N.Y.S.2d 105 (A.D. 2011), illustrates how difficult it can be for a new venture to establish lost profits with reasonable certainty. Blinds To Go was not a completely new business. It was a chain with four existing stores in the New York area that sold custom-made window blinds. It planned to open a fifth store in Brooklyn and entered into a lease of retail premises. Before it opened the store, the landlord breached the lease by terminating it without justification. Blinds To Go sued the landlord for damages, including lost profits. At trial, it sought to prove those lost profits by expert evidence of the profits at its three existing stores. The jury awarded Blinds To Go about $3.75 million in lost profits. The Appellate Division overturned the jury award on the grounds that the weight of the evidence did not support it. Although Blinds To Go was not a startup business, the court treated the Brooklyn store as a new venture because it was an attempt to break into a new market. The court found that Blinds To Go had not proved with reasonable certainty that the stores in other areas were comparable—they were more suburban in nature, the customer demographics and median income were different, and there was no parking in front of the Brooklyn store. The court ordered a new trial on the issue of damages, and hinted that the lost profits might be proved with a more adequate degree of certainty by expert testimony on the profitability of comparable stores in Brooklyn. Of course, for many new businesses, a mere showing of the profitability of comparative businesses in the area will not likely be enough to establish with reasonable certainty that the new entrant into the market would achieve profits at that level. In addition, the plaintiff would have to address many variables, such as the impact of a new business on the market, likely changes in the economic environment, the degree of expertise and experience of the management, the viability of the business plan, and the plausibility of income and expense projections.

§18.6.6 Unfair Forfeiture

The principle of unfair forfeiture is discussed in section 17.3.4 in relation to damages for substantial performance. Recall that the general principle, as reflected in *Jacob & Youngs v. Kent*, 129 N.E. 889 (N.Y. 1921), is that when a contract has been substantially performed and the cost of rectifying the immaterial and nonwillful breach is disproportionately large in relation to the value of the benefit that full performance will confer on the plaintiff, diminution of the ultimate value of the performance may be a more appropriate measure of damages. However, *Jacob & Youngs* confined this principle to situations in which there had been substantial performance. Where the breach is material, there is seldom a justification to limit damages merely because the amount needed to achieve the plaintiff's contractual expectations exceeds the enhancement of the ultimate objective market value of the promised performance. For example, in *American Standard, Inc. v. Schectman*, 80 A.D.2d 318 (1981), the owner of an industrial site sold the buildings and other movable property in exchange for $275,000 plus a promise to grade the property and to remove foundations and other structures from the property to a foot below grade level, leaving the vacant site in a reasonably attractive condition for resale. The buyer removed the property it had bought but did none of the grading and restoration work. The seller sued the buyer for $110,000, the cost of doing the work. The buyer sought to prove that its failure to restore the land reduced its market value by only $3,000, but the court refused to admit this evidence on the ground that the restoration of the land was a significant part of the consideration exchanged for the property sold and the parties intended the restoration of the property to be a material term of the contract. (In addition to this, *American Standard* is distinguishable from *Jacob & Youngs* because the breach was deliberate, not inadvertent.)

Peevyhouse v. Garland Coal & Mining Co., 382 P.2d 109 (Okla. 1963), is a famously controversial case that applied these principles where a mining company breached its contract with a landowner by failing to restore the land on completion of its strip-mining operations. The court refused to award damages to the owner based on the cost of restoring the land because that cost was greatly disproportionate to the amount by which the restoration would increase the land's market value. The court justified its decision by finding, probably incorrectly, that the restoration of the land was not a central obligation of the contract, but merely incidental to the contract's purpose of extracting coal for mutual profit. The restoration of the land after it had been devastated by strip mining could well have been a material part of the consideration reasonably expected by the owner, even if the value of the restored land was low in relation to the cost. (This would be even more likely today than in the 1960s with the contemporary emphasis on environmental protection.) It must again be stressed that damages should not be reduced or disallowed on the unfair forfeiture principle merely because the cost of rectifying the defective performance exceeds the ultimate economic value of that performance. The crucial question is whether the failure to award damages based on the cost of rectifying the performance would deprive the plaintiff of a material benefit contemplated by the contract.

§18.7 RELIANCE AND RESTITUTION AS ALTERNATIVES TO EXPECTATION

Although expectation damages are the primary remedy for breach of contract, they can only be recovered to the extent that the plaintiff can prove that the breach deprived her of an economic gain that would have resulted from the performance promised by the defendant in the contract. She must be able to show that she received less than her entitlement under the contract or was otherwise precluded from realizing an expected gain. It can happen that a breach causes no economic loss because, say, a substitute transaction can be found at the same or a lower cost, or because the contract was not profitable. If no loss can be shown, the plaintiff has no recourse for the defendant's wrongful act because there is no need for monetary compensation and contract remedies are not aimed at penalizing breaches. For example, if the seller of a house breaches the contract, but the buyer can purchase an equivalent house for the same or less money, the buyer has not suffered an economic loss in expectation and has no recourse for expectation damages against the seller.

However, the plaintiff's inability to prove expectation damages does not always end the matter of relief, because she may be able to show that she has suffered losses other than her defeated expectation. For example, it is possible that she incurred transaction costs in dealing with the breach and entering the substitute transaction. If so, she could claim this loss as incidental damages, as explained in section 18.2. Quite apart from incidental damages, the victim of the breach may have incurred expenditures or losses by partly or fully performing under, or relying on, the contract before its breach. For example, in the above illustration involving the seller's breach of the contract to sell the house, the buyer may have partly performed before the breach by, say, paying a deposit to the seller. The buyer may also have incurred expenses in anticipation of receiving the benefits of the contract, say, by paying an architect to plan an alteration to the house. Damages of this kind may be recoverable under one or both of the alternative remedies of reliance and restitution.

The basic difference between reliance and restitution is that reliance, like expectation, is conceived of as a remedy based on affirmation of the contract—it is an enforcement of the contract, but restitution is premised on the theory of disaffirmance—it treats the breach as having caused the contract to fall away. This distinction, which will be made clearer as the remedies are discussed below, affects the aim and focus of the remedies. While the goal of expectation damages is to place the plaintiff in the position she would have been in had the contract been performed, reliance and restitutionary damages have more limited goals. Reliance damages aim to refund expenses wasted or equivalent losses by the plaintiff in reliance on the contract, thereby restoring her to the status quo ante—the position she would have been in had no contract been entered. Restitution seeks to return to the plaintiff the value of any benefit conferred on the defendant under the breached contract. It focuses not on the plaintiff's expectation or expenditure, but on the extent of the defendant's enrichment at her expense.

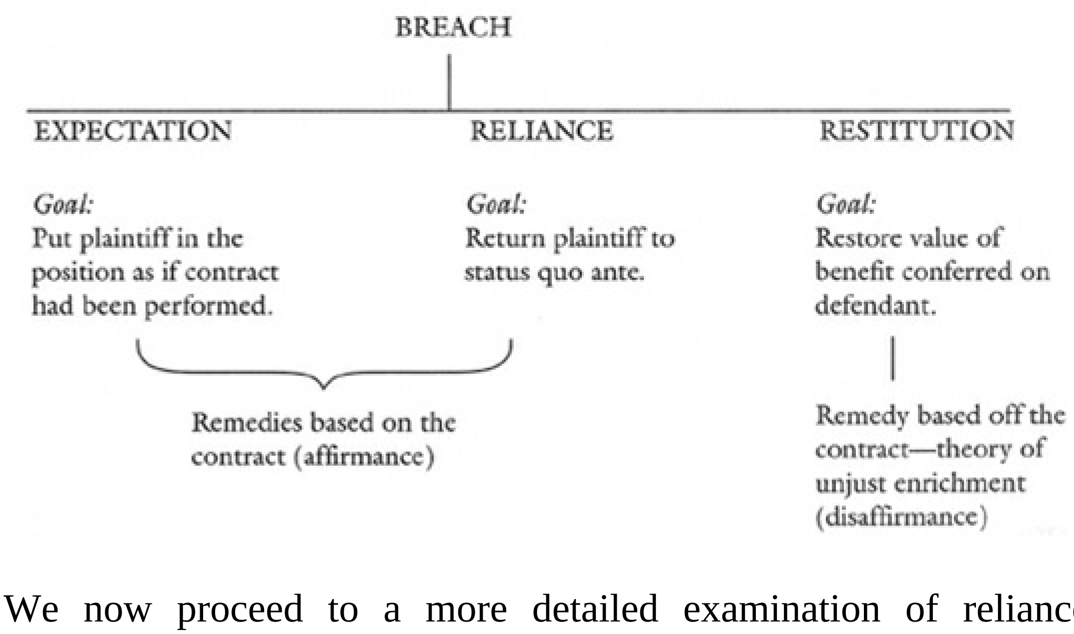
You should recognize, from the above description, that there is a close similarity between the reliance or restitutionary damages described here in connection with damages for breach of contract and the equivalent remedies discussed in relation to promissory estoppel (section 8.7) and unjust enrichment (section 9.6). Although the remedies are much the same, the cause of action that creates them is different. We deal with them here as possible bases of recovery for breach of contract rather than as remedies where no contract was created, but the law recognizes liability based on other grounds.

To illustrate the availability of and distinction between expectation, restitution, and reliance damages following a breach of contract, let us slightly embellish the above example of the house sale: The seller contracted to sell the house to the buyer for $150,000. After the contract was signed, the buyer paid $5,000 to the seller as a deposit. She also hired an architect to draw a plan to enlarge the living room and paid him a fee of $1,000. If, after the seller breaches, the buyer finds a reasonable replacement house for $155,000, she will claim and be entitled to expectation damages in the total amount of $11,000 because this is what she must receive to be in the position of having a house for $150,000. She gets not only the $5,000 extra cost of a substitute but also reimbursement of her costs of $6,000 expended in reliance on the contract. Part of that reliance is the $5,000 she actually paid to the defendant—called "essential" (or sometimes "direct") reliance, and part is the $1,000 wasted in having plans drawn that are now useless to her—called "incidental" (or sometimes "consequential") reliance.[12]

However, assume that the buyer is able to purchase a replacement house for the same or less than the contract price, so she has suffered no loss in expectation. She would still be able to obtain reliance damages of $6,000 that would restore her to the status quo ante. If she chose to, she could instead recover restitutionary damages, but the benefit conferred on the seller is only $5,000. (Although the plans relate to the seller's house, she is not enriched by them because she did not ask for them to be drawn and presumably does not even have them.) Therefore, the buyer has no incentive to choose restitution in preference over reliance.

Notice that some items of damage are recoverable no matter which form of relief is sought. In this case the $5,000 deposit is both a reliance expense (and consequently also part of expectation damages) and a benefit subject to restitution. Others may be consistent with only two (here, the wasted architect's fee is counted in both expectation and reliance) or available only under one (the cost of a substitute is claimable only under expectation). Naturally, the plaintiff will select as her first choice whichever of the alternative remedies provides the widest relief. The basic distinction can be represented as shown in Diagram 18F.

Diagram 18F



We now proceed to a more detailed examination of reliance and restitution as alternatives to expectation and to each other.

§18.8 RELIANCE DAMAGES

§18.8.1 The Distinction Between Essential and Incidental Reliance

It is noted earlier in section 18.7 that when a loss or expense is incurred in performing an obligation under the contract, the reliance motivating it is called “direct” or “essential” because it is directly based on the contract and essential to fulfilling the party’s contractual commitment. However, if a loss or expense is incurred as a consequence of and incidentally to the contract, for the purpose of enjoying or taking advantage of the benefit expected from the contract, it is called “consequential” or “incidental.” It is important not to confuse incidental reliance damages with incidental damages, which are discussed in section 18.12. Even though these two types of damages share the word “incidental,” they are not related and are completely different, as explained in this section and section 18.12.

Sometimes the distinction between essential and incidental reliance is easy to draw, as in the case of the deposit and the payment for the architect’s plan in the prior illustration. However, the question of whether something is essential or incidental to a party’s contractual performances requires an interpretation of the party’s obligations under the contract. In some cases the distinction may be harder to draw. For example, the owner of a store hires a signmaker to execute a large neon sign and to install it on the front façade of the building. In the contract, the signmaker guarantees that it will obtain approval for the sign from the city. The owner spends money in reinforcing the front of the building so that it can bear the sign, but the signwriter is unable to obtain approval for the sign. Because he promised to do this, he has breached the contract. If we interpret the owner’s structural work on the building as necessary to enable the signmaker to perform, the expense incurred in doing the work is essential reliance. However, if we interpret the purpose of the reinforcement merely as a means for the owner to obtain the benefit of the signmaker’s performance, then the erection costs are incidental reliance. In some cases, the distinction may not have any significant effect on the result, but as discussed below, different rules apply to these different types of reliance, and the characterization could be significant.

There is one important point to bear in mind no matter how reliance expenses are classified. The basis of awarding reliance damages is waste or loss. The plaintiff must be prejudiced in that something of value has been wasted or lost and cannot be salvaged. Thus, in the above example, the building owner’s purpose in reinforcing the building was defeated when the signmaker could not get city approval of the sign. If the only function of the reinforcement was to accommodate the sign, the expense is wasted. However, if the reinforcement has other benefits—for example, it improves the structural soundness of the building, the expense may not be a waste.

§18.8.2 Essential Reliance Damages

We have already seen in section 18.3 that in many types of contracts (especially when the aggrieved party's performance consisted of the supply of work or work and materials), expectation damages are made up of expected profit on the whole contract plus expenditure already incurred in reliance on the contract. In cases like this, essential reliance expenses are therefore a component of expectation recovery. For example, a builder contracts to build a house for $150,000. After the builder has performed about half of the work and spent $60,000, the property owner breaches by terminating the project. The builder can prove that his total cost to build the house would have been $120,000. His expectation damages are $90,000, consisting of his lost profit of $30,000 as well as the reimbursement of the expenses of $60,000 already incurred. Both these components must be included to give him the benefit of his bargain—a net gain of the $30,000 profit.

On the above facts, the builder could prove that his total cost would have been less than the contract price, so he can show that he expected a profit. However, this is not always the case. A plaintiff may have no reliable evidence from which to project his total expected costs, or he may have underbid so that projected total cost exceeds the contract price. If the plaintiff cannot prove that he would have made a profit on the contract had it been fully performed, he cannot claim a loss of profit. He is nevertheless still entitled to recover the essential reliance component of his damages—the $60,000 actually spent in performing. (As these examples show, a plaintiff who can prove profit has no reason to confine his claim to reliance damages.)

When the plaintiff would have made a loss in full performance of the contract—that is, he had a negative expectation—the defendant's breach is a lucky break. It allows him to cease performance and curtail his loss. This means that if he is awarded his full reliance damages, he actually does better than he expected. For example, say that the builder agreed to build the house for $100,000, but his total cost to complete it would have been $120,000 so that he has an expected loss of $20,000. The owner breaches about halfway through the construction. At that point the builder has spent $60,000. If he is given the full $60,000, he recovers all his costs. Yet had he completed his contract performance, could only have recovered five-sixths of his cost. A convincing argument could be made that this should not be the basis of any adjustment. The defendant breached and cannot be heard to complain if the breach enabled the plaintiff to avoid expected losses. However, because the law is concerned with trying to give the plaintiff true expectation, some courts consider it appropriate to take negative expectation into account when reliance damages are claimed. However, they qualify this rule by shifting the burden of proving negative expectation to the defendant. The allocation of this burden of proof to the defendant recognizes that the defendant was in the wrong for breaching the contract. Therefore, a plaintiff seeking recovery of reliance damages need only prove his expenditure and need not show that he would not have made a loss on the contract. If the defendant seeks to reduce the award, she must show that it would have been a losing contract. This means that when projected costs are uncertain and the fact of loss unclear, the defendant's failure to sustain the burden of proof will result in the plaintiff obtaining full reimbursement of expenses.

Therefore, the general rule is that when the defendant can prove that the plaintiff would have suffered a loss in the event of complete performance, the plaintiff's reliance damages should be reduced to bring his recovery into line with his expectations. Although some courts speak merely of the deduction of expected loss from the award of expenses, it is fairer and more consistent with the goal of compensation to reduce the recovery proportionally. That is, to prorate the loss and to reduce the recovery of expenses by a percentage of the total loss equal to the ratio of expenses incurred to total expenses. Thus, on our facts, the builder has incurred half the costs, so his recovery should not be reduced by the full expected loss of $20,000, but only by half the expected loss, $10,000. He therefore recovers $50,000 of the $60,000 spent. This takes into account that he did not have the expectation of recovering all his costs, but it does not undercompensate him (and reward the breacher) by diminishing his recovery by the full loss that he would have suffered had the contract been completed.

A pro rata reduction of reliance is not appropriate in every case. Even if the defendant can prove that the plaintiff will ultimately have lost money on the contract, reliance expenses should not be reduced if the purpose of the contract was not to make a profit. For example, a homeowner contracts with an artist to execute a large and colorful mosaic at the entrance to his property. After the owner has incurred expense in preparing the property for the installation of the mosaic, the artist repudiates. The owner should be able to recover his wasted expenses as reliance damages even if expert testimony from real estate brokers shows that the owner would have lost money had he installed the flashy mosaic because it would have reduced the market value of the house. This is not a proper case for reducing reliance recovery because enhancement of the property value was not the purpose of the contract, and the possibility of economic loss is not relevant to the reimbursement of the wasted costs.

§18.8.3 Incidental Reliance Damages

As stated earlier, incidental reliance expenditure or loss is incurred in consequence of having made the contract and for the purpose of using or enjoying the benefits expected under it. (Again, do not confuse incidental reliance damages with incidental damages, discussed in section 18.12.) Because incidental reliance damages are premised on the plaintiff's reliance on the contract, they must necessarily have been incurred after the contract was entered into. A loss or expense incurred in anticipation of the contract, but before it is actually formed, is therefore not included in incidental reliance damages.[13]

Incidental reliance may be illustrated and distinguished from essential reliance by the following example: Jim Nast enters into a lease of premises for the purposes of opening a gym. Jim has not run a business before, and this will be a new venture for him. At the time of signing the contract, Jim paid a deposit of $5,000 to the lessor as required under the contract. In addition, a short time before the business was due to open he spent $1,000 on flyers, which he planned to distribute to advertise the opening of his gym. A few days after he had incurred this expense, the lessor breached the lease by letting the premises to someone else. Say that no other suitable premises are available, so Jim has to abandon his attempt to open the gym. Because this would have been a new business and Jim does not have credible evidence to claim lost profits as expectation damages, he decides to confine his claim to reliance damages. He has suffered both essential reliance damages—the deposit paid to the lessor as required by the contract, and incidental reliance damages—the wasted expense of the useless flyers. The former expense qualifies as essential reliance because it was incurred as part of his performance obligation. However, he had no contractual duty to have the flyers printed. He did this solely for his own purpose of attracting business. Even so, the expense was incurred in reliance on the contract, and the breach has defeated that reliance and made the expenditure useless.

Most commonly, incidental reliance takes the form illustrated above—an expenditure or outlay that is wasted as a result of the breach. But sometimes it is in the nature of a lost opportunity or other gain sacrificed. For example, after executing the lease of the premises, Jim had given up his job so that he could operate his new gym, or he had declined an offer of other premises on the strength of this lease. Lost gains and opportunities are, of course, harder to prove and quantify than wasted expenditure, but they are recoverable if properly established, subject to the qualifications discussed below.

Because incidental reliance is ancillary to the contract, there must be a limit on it to protect the breaching party from liability for expenses that it could not fairly have expected, or that were not incurred reasonably. Therefore, incidental reliance is only recoverable if the defendant foresaw or reasonably should have foreseen the possibility of the loss or expenditure being incurred, and both the amount and nature of the loss or expenditure were reasonable. The mitigation principle applies here too, but it need not be stated as a separate requirement because it is inherent in the concept of reasonable reliance. As with all other types of damage, the loss or expense must be proved with reasonable certainty. As noted before, incidental reliance is only compensable to the extent that it had been wasted. Therefore Jim could not claim wasted expenditures for the flyers if the breach occurred before they were printed and he had the ability to cancel the order. Similarly, if the loss can be salvaged or the items reused, any recoupment of the waste will limit the claim. (Again, this is consonant with the mitigation principle.) For example, say that in addition to flyers, Jim had bought some gym equipment. Unlike the flyers, the equipment can be resold and the proceeds of resale will curtail the loss.

Where the contract relates to a money-making enterprise, the plaintiff's costs, including incidental reliance costs, would be deducted from prospective earnings to determine profit. Therefore, if the defendant can prove that the plaintiff would not have made a profit from the enterprise, it would be appropriate to apply the prorating principle discussed in section 18.8.2 to proportionately reduce the incidental reliance damages. However, in other situations, where profit is not an issue, incidental reliance damages should not be subject to the rule of proportionate reduction. For example, the cost of Jim's flyers would be a business expense to be deducted from the gym's earnings to determine profit, so if the lessor can show that the gym would have made a loss, it would be appropriate to reduce the cost of the flyers proportionately. However, in the illustration in section 18.7 involving the drafting of architectural plans following the sale of the house, the question of whether the buyer would have made a profit or loss is irrelevant because the renovation of the house is not for a profit motive but to enhance the home for the buyer's use.

§18.9 RESTITUTIONARY DAMAGES

Restitutionary damages are explained in section 9.6, in which the basic premise of the remedy and measurement of relief are introduced. While the pertinent aspects of that discussion will be restated briefly in the course of this section, you should refer to those sections if you want more detail. The purpose of restitutionary damages is to restore to the plaintiff the value of a benefit unjustly conferred on the defendant.[14] Section 9.6 focuses on unjust enrichment as a theory of liability alternative to contract and deals with situations in which the remedy of restitution is granted when a benefit was conferred on the defendant in the absence of contract. However, restitution is also available when a valid contract has been entered into and materially breached, because the plaintiff has the option of either suing on the contract for expectation or reliance, or of disaffirming the contract (that is, operating under the legal fiction that it does not exist) and suing in restitution for the recovery of benefits conferred under the now-defunct contract.

Stated differently, when the defendant commits a material breach, the plaintiff will, when possible, usually seek full enforcement of the contract to recover the value of her expectation. However, if the plaintiff cannot recover expectation damages either because she has not suffered any expectation loss, or she cannot prove expectation damages, or because she has a negative expectation (that is, she would have lost money on the contract), she will be able to choose to recover in either reliance or restitution. If she claims reliance damages, she is still suing on the contract because, as explained above, reliance expense is a component of expectation damages. However, if she claims restitution, she proceeds on the theory that the breach ended the life of the contract, so that the defendant is no longer justified in retaining the benefit of any performance that the plaintiff rendered to her under it, and the value of that performance unjustly enriches her.

To understand why restitution often provides a different measure of recovery from reliance, one needs to remember their different goals, as mentioned in section 18.7: Reliance is aimed at the recovery of wasted expenses, while restitution is designed to restore the value of a benefit that the defendant has unjustly retained. Sometimes the plaintiff's expenditure may be exactly equal to the defendant's enrichment, so it would make no difference which basis of recovery was used. This is true, for example, when the benefit to the defendant is simply the payment of money. Therefore, if the seller of a house breaches the contract of sale after the buyer has paid a deposit of $5,000, the value of the benefit conferred is precisely equivalent to the plaintiff's expenditure (and interest on the money would be claimable in both restitution and reliance). However, in other situations the plaintiff's outlay could be considerably different from the value of what it produced. Say that a painter entered into a contract to paint a house, and the owner breached after the painter had stripped and primed the walls. If the painter had incurred expenses of $100 in doing this preparatory work, that is all he can recover in reliance. However, restitution based on the value of what has been done for the owner—commonly measured by the market value (quantum meruit) of the service—is likely to be more than what was actually spent. This is because it includes not only the cost of performance but also the value of the plaintiff's labor or a reasonable profit. Conversely, restitution could be lower than reliance where the expenditure, although justifiable and reasonable, does not result in a benefit to the owner. This is particularly likely when the reliance is incidental so that nothing is actually given to the breacher.

Although market value is the preferred measure of value, the recipient's net gain is sometimes more appropriate. The factors that are taken into account in selecting the means of measurement are discussed in section 9.6 and are not repeated here. However, when restitution is based on the disaffirmance of a breached contract, there is one further question concerning the measurement of the benefit: If the market value of the benefit exceeds the value placed on it in the contract (that is, its contract price), should the contract price be an upper limit on recovery? For example, in the above contract to paint a house, say that the portion of the contract price attributable to stripping and priming the walls is $500, but the painter underbid and this price is lower than the market value of the work, which is $600. The argument against making the contract price the upper limit on recovery is that restitution, by its very nature, is based on the theory that the contract no longer exists as a result of the breach. It unduly benefits the breacher to use the price in the contract to limit his restitutionary liability. The argument in favor of limiting recovery to the contract price is that the distinction between affirmance and disaffirmance is artificial—it is a legal fiction and a contract was actually made. Because the plaintiff's expectation of loss is taken into account for reliance damages (as explained in section 18.8.2), consistency demands that the plaintiff's expectation should limit restitutionary recovery as well.

§18.10 EQUITABLE REMEDIES: SPECIFIC PERFORMANCE AND INJUNCTIONS

§18.10.1 Specific Performance

It is noted in section 18.2.2 that the remedy of specific performance—a court order commanding the defendant to perform the contract as promised—would seem to be the most precise means of achieving the plaintiff's expectation. Yet, for a number of reasons, some historical and some based on practicality and principle, damages are the primary form of relief for breach of contract, and specific performance is reserved as an extraordinary remedy. The historical basis for the primacy of the damages remedy lies in the dichotomy between law and equity. As it was originally formed, the court of equity was a court of special resort, presided over by the Lord Chancellor, acting under the sovereign's prerogative power. The Lord Chancellor would exercise his discretion to do justice only where the overall equities of the case called for this intervention and the regular courts of law had no power to provide an adequate remedy to the plaintiff.[15] Although courts of law and equity have long been combined, and the same court decides on the alternative remedies of damages and specific performance, the requirement of establishing equitable grounds for the special relief of specific performance still exists in our law. These grounds are set out below.

Where a court orders specific performance, it compels the defendant to render the performance that he has promised under the contract. Unlike an award of damages, which operates *in rem*—it is a money judgment enforceable against the defendant's property[16]—an order of specific performance operates *in personam*. This means that it is a command of the court directed at the person of the defendant. If she disobeys it, she can be sanctioned for contempt of court and jailed or fined. The potential of punishment for disobedience is one of the considerations that may give a court pause in deciding if the remedy is apposite.

When an order is granted and obeyed, the defendant honors his contractual obligations. Therefore, the plaintiff must do so as well. If she has not fully performed her part of the bargain, she must render the return performance promised to the defendant, and the court may grant its order conditional on the plaintiff doing so.

Where the order for specific performance gives the plaintiff her complete expectation, there is no occasion to award her damages as well. However, when the breach has caused a loss that will not be completely averted or recouped by specific performance, it is appropriate for the court to award damages to compensate for that irretrievable loss in addition to granting specific performance. For example, if the defendant refuses to convey business premises purchased by the plaintiff, the court could decree specific performance and also award the plaintiff whatever loss in profits she can prove that she suffered for the period of delay between the date for delivery under the contract and the date on which the order is finally complied with.

a. Inadequate Remedy at Law

Because the court of equity intervenes to give a remedy only where the legal remedy of damages is inadequate, the plaintiff seeking specific performance must show that the normal legal remedy of damages would not provide adequate relief. This might occur, for example, where the contract is for the sale of unique property that cannot be substituted for on the market, or where damages would be very difficult to prove with reasonable certainty. Although it is founded on the traditional dichotomy between law and equity, the requirement that the plaintiff shows that damages would be an inadequate remedy has survived the consolidation of courts of law and equity, and is reflected in Restatement, Second, §359; UCC §2.709 (the seller's action for the price); and UCC §2.716 (the buyer's remedy for specific performance). The continuing vitality of the rule is not based solely on tradition, but can also be justified on grounds of efficiency. If damages are an adequate remedy, a monetary award is often a simpler, fairer, and less intrusive means of providing relief to the plaintiff.

The determination of whether damages are not an adequate remedy requires an evaluation of the purpose of the contract and the nature of the harm that will be suffered by the plaintiff as a result of its breach. Where the contract involves the sale of real property, courts tend to grant a decree of specific performance quite readily. This is because of a long-established view that real property is unique, so that monetary compensation for the cost of a substitute is not an adequate remedy. This approach may be justified in some cases—where the real property has qualities that cannot be replicated by a substitute. However, it is less supportable where there is nothing special about the property and the market price of a substitute is readily calculable. (For example, it is questionable to find the legal remedy to be inadequate where the subject of the sale is a home of standard design in a tract development in which similar homes are available.) Nevertheless, courts tend to award specific performance quite routinely in sales of real property.

In situations other than sales of real property, courts evaluate the claimed inadequacy of damages more critically. For example, in *Van Wagner Advertising Corp. v. S&M Enterprises*, 492 N.E.2d 756 (N.Y. 1986), the owner of a building leased space on the building's exterior wall to an advertising agency for a term of several years. The wall faced an exit ramp of the Midtown Tunnel and was therefore visible to traffic using the ramp. The lessor breached the contract by terminating the lease, and the advertising agency sued for specific performance on the grounds that the exposure of the wall to the busy exit ramp made it unique. The trial court refused summary judgment and awarded damages to the agency. The court of appeals affirmed. Although it accepted that the building wall offered advertising exposure that was, in a sense, unique, the court said that this was not enough to support the remedy of specific performance. Uniqueness must be judged in light of the difficulty or ease of measuring the cost of a substitute having the special qualities of the leased property. There is a much stronger argument for awarding specific performance if the information available to assess the financial loss resulting from the breach is scanty or unreliable, leading to a high risk of the inaccurate measure of compensation. However, in this case, the agency's loss could be calculated quite reliably because it had subleased the space for part of the time and its loss on that lease was reliably quantifiable. As to the remainder of the lease term, there was a well-established market for commercial billboard space from which the value lost by the agency could be readily calculated.

Where goods are sold, the assumption is contrary to that usually applied to sales of real property—except in special circumstances, goods are not considered unique. UCC §2.716 therefore relegates the buyer to a claim for damages, and she cannot get an order compelling the seller to perform unless she can show that the goods are unique or that the circumstances otherwise justify the order. Comment 2 to that section explains that to be unique, an item does not necessarily have to be the only one of its kind in existence. The concept is broader than that and covers any situation in which it is not commercially feasible to obtain a substitute.

b. The Balance of the Equities and Hardship to the Defendant

As in any equitable remedy, the court considers the impact on the parties of granting or denying the remedy. That is, one of the factors that it takes into account is the balance of the equities and hardships between the parties. For example, in *Kilarjian v. Vastola*, 877 A.2d 372 (N.J. Super. 2004), the Kilarjians bought the Vastolas' house. The Vastolas breached the contract by refusing to proceed with the transfer and the Kilarjians sued for specific performance. The court noted that under ordinary circumstances, specific performance would be an appropriate remedy because real property is presumed to be unique. However, the reason why the Vastolas breached was because Mrs. Vastola was suffering from a serious, progressive neurological condition that disabled her and made it very difficult for the Vastolas to move. The court recognized that this was a hard case because the Kilarjians were entitled to the benefit of their bargain. However, it exercised its equitable discretion and refused specific performance on the grounds that it would be heartless and unjust to evict an ill woman from her home. Instead, the court remanded the case to the trial court to determine the Kilarjians' damages. (On the facts of the case, their damages consisted of their wasted expenditures plus any amount by which their financing costs may have increased as a result of the breach.)

In *Kilarjian*, the hardship to the defendant was profound and tragic. However, it is not always necessary to show hardship of this degree to avert an order of specific performance. In deciding whether it is appropriate to decree specific performance, a court is aware of the potential sanction for contempt of court if a defendant should disobey the order, and is likely to be sensitive to the question of the intrusiveness of the order and any difficulty a defendant may have in performing as promised. Hardship to the defendant is taken particularly seriously where the performance involves personal services. The courts' concern over forcing the performance of personal services (which is often equated to involuntary servitude) makes it most unlikely that a court will ever specifically enforce such an obligation. There is also a strong efficiency and practicality of enforcement argument against compelling the performance of personal services because of the possibility that the service would be performed grudgingly and would require careful court supervision.

c. Practicality of Enforcement

In considering whether to grant an order of specific performance, the court takes some account of the ease or difficulty in enforcing the order, and the extent to which the court will be required to supervise the performance and deal with disputes over whether performance is in accord with the contract. Some orders of performance are easy to enforce. For example, if the court orders specific performance of a contract to sell real property, the sheriff can enforce this by evicting the defendant and executing the documents transferring title to the plaintiff. However, other cases may involve a more complex performance that requires judicial monitoring to ensure that a reluctant defendant does not provide a grudging performance that falls below the reasonable standards required under the contract. This does not mean that a court will refuse an order of specific performance just because it needs supervision. But the ease or complexity of enforcement is a factor that goes into the balance. If the court concludes that specific performance is necessary to do justice, it will undertake the required supervision and may appoint a special master or some other person accountable to the court, who will evaluate performance and possibly mediate any disputes that might arise in the course of carrying it out.

d. Indefiniteness

It is a general principle of equity that a court will not make a vague order. Its command must clearly tell the defendant what he must do to obey and avoid sanctions for contempt. This principle, combined with the courts' reluctance to invent contract terms for the parties, leads to the rule that specific performance will not be decreed unless the contract is definite enough to form the basis of a clear order. In Chapter 10, it is noted that if the parties' agreement is too vague or indefinite, their arrangement may fail to qualify as a contract at all. However, even if the uncertainty is not so severe as to defeat a claim that a contract was made, it could render the contract too unclear to support an order of specific performance.

e. Public Interest and the Interests of Innocent Third Parties

As with all equitable remedies, one of the factors that the court weighs is the impact of an order of specific performance on the public interest. Because specific performance involves the enforcement of a private contractual arrangement between the parties, concerns about the general public good will not always be implicated. However, the public interest is included in the balance where an order compelling performance, or the refusal of such an order, does have some impact on that interest. For example, one can see the public interest dimension in the reference, in section 18.10.1b, to concerns about involuntary servitude in the compulsion of a personal services contract.

The harm that an order of specific performance may have on the rights and interests of innocent third parties may also have an impact on the court's decision on whether to grant the order. For example, the seller of a house breached a contract to sell it to the plaintiff by selling it to someone else. The second buyer entered the transaction in good faith and without knowledge that the sale was in breach of the seller's contract with the plaintiff. If the court awards specific performance to the plaintiff, this would force the seller into breaching the contract with the second buyer. A court may decide that the harm caused by the order to the second buyer outweighs the equities in favor of granting specific performance to the plaintiff.

§18.10.2 Injunctions

An injunction is an equitable remedy under which a court grants an order that either compels the defendant to perform a specified act—called a mandatory injunction—or prohibits the defendant from performing a specified act—called a prohibitory injunction. An order for specific performance is really just a form of injunction, and the standards described in section 18.10.1 for the grant of an order for specific performance apply to injunctions generally, whether mandatory or prohibitory: A court will not issue an injunction to compel or enjoin the defendant's conduct unless the plaintiff can show that the less intrusive legal remedy of damages is inadequate and that the need to protect the plaintiff's rights under the contract outweighs any hardship that the injunction might impose on the defendant, any problems of supervising the order, and any harm to the rights of innocent third parties or the public interest.

In most cases, an order of specific performance is in the form of a mandatory injunction—a court order compelling the defendant to render the performance that he promised in the contract. However, in some situations, where a contract forbids certain conduct, an order of specific performance takes the form of a prohibitory injunction. That is, the order directs the breaching party not to take action that violates the terms of the contract. For example, in *Walgreen Co. v. Sara Creek Property Co.*, 966 F.2d 273 (7th Cir. 1992), Walgreen had a long-term lease of premises in a shopping mall owned by Sara Creek. The lease provided that Sara Creek would not lease premises in the mall to another pharmacy. Sara Creek breached this term by entering into a lease with a discount store that had a pharmacy department. Walgreen sued Sara Creek, seeking an injunction prohibiting it from letting the premises to Walgreen's competitor. The court of appeals affirmed the trial court's grant of the injunction. The court noted that damages are the norm in a breach of contract case, and are usually the most efficient remedy. Therefore, the court will not grant an injunction unless the plaintiff can justify it by showing extraordinary circumstances and a balance of the equities in favor of granting it. Walgreen had demonstrated that an injunction was the most appropriate remedy in this case because the lease term was for many years and Walgreen would have great difficulty in accurately proving its loss of profits and goodwill over the term of the lease. The injunction was a simple prohibition and would not require court supervision, and neither Sara Creek nor the competing pharmacy would be unduly harmed by it.

A prohibitory injunction may also be helpful to a plaintiff where it is not aimed directly at conduct in violation of the contract, but instead strikes at the defendant's motivation to breach. That is, if the defendant's purpose in wrongfully terminating a contract was to enter into a more advantageous contract with someone else, an injunction prohibiting the defendant from performing the other contract could eliminate the advantage of breaching and encourage the defendant to relent. For example, say that Sara Nade contracted with Smalltime, Inc. to perform a concert. Sara repudiated the contract a short time afterward because she received a much more lucrative offer from Worldwide Promotions, Inc. to perform on the same night. The court will not grant an order of specific performance to compel Sara to perform this personal service for Smalltime, but it may be willing to enjoin Sara from performing for Worldwide. This does not help Smalltime directly, but it removes Sara's motive for breaching and encourages her to retract her repudiation.

§18.11 LIQUIDATED (AGREED) DAMAGES

§18.11.1 The Test for Enforcing a Liquidated Damages Provision

A liquidated damages (also called "agreed damages") provision is a term in a contract under which the parties agree that if a party breaches the contract, he will pay damages in a specified sum or in accordance with a prescribed formula. If such a clause is valid, it has the effect of settling in advance what damages will be due by that party in the event of a breach and binds the breacher to pay damages in that amount irrespective of whatever actual damages might be. The contract could have a liquidated damages provision that specifies the damages due by each of the parties in the event of breach by that party, or it could liquidate damages for only one of them. (If the liquidated damages clause covers breach by only one party, a breach by the other will require proof of damages in the usual way.) Unless the provision makes it clear that the liquidated damages are the plaintiff's exclusive remedy, Restatement, Second, §361 assumes that it does not prevent the plaintiff from electing to claim specific performance instead of damages.

There are a number of reasons why the parties may agree to commit themselves in advance to a set amount of damages in the event of breach: The principal one is that if damages are stipulated in the contract, it is easier and more efficient to obtain relief if a breach occurs, particularly if the transaction involves a venture that is speculative. The plaintiff avoids the problem of establishing foreseeability, mitigation, and certainty, and the defendant has a predetermined liability so that she can better predict the cost of breaching. In fact, if one of the parties is particularly concerned about protecting itself from the problem of establishing damages in the event of breach, the ability to stipulate damages in the contract may be a significant incentive to entering the contract.

However, liquidated damages have an obvious negative aspect. They are nothing more than a forecast of probable loss. Even if the parties try hard to make as precise and thoughtful a prognostication as possible, they can never prophesy exactly what the actual losses will be. If the outcome of the transaction is uncertain or speculative, reasonably accurate prediction of the impact of breach becomes more unlikely. The problem of unreliable prediction is, of course, increased to the extent that the parties are less careful in their projections. It may therefore turn out that the forecast of damage is very different from the loss that ultimately results from a breach, and that the agreed damages greatly overcompensate or undercompensate the plaintiff.

Two policies of contract law are in tension when a court is called on to enforce a fairly bargained liquidated damages provision. The policy of freedom of contract points in the direction of enforcing what the parties agreed, but the compensation policy (confining contractual relief to economic compensation) points in the direction of not enforcing a provision that goes beyond compensation to impose a penalty for breach of contract. Courts tend to give greater weight to the compensation policy. Therefore, if a party challenges a liquidated damages provision, the court will evaluate it to determine if it was a genuine attempt by the parties to settle damages in advance. If it was not, the court will characterize it as a penalty—a provision having the purpose or effect of punishing or deterring breach by imposing liability beyond reasonably anticipated loss—and will refuse to enforce it. If the court refuses to enforce the provision as a penalty, the victim of the breach must prove the actual damages that it suffered in the usual way. Note that the issue of whether to enforce a liquidated damages provision is independent of questions of bargaining unfairness, such as duress, fraud, or unconscionability. Of course, if assent to a liquidated damages clause is obtained by one of these improper means, that would in itself provide grounds for invalidating it, even if the provision is not a penalty.

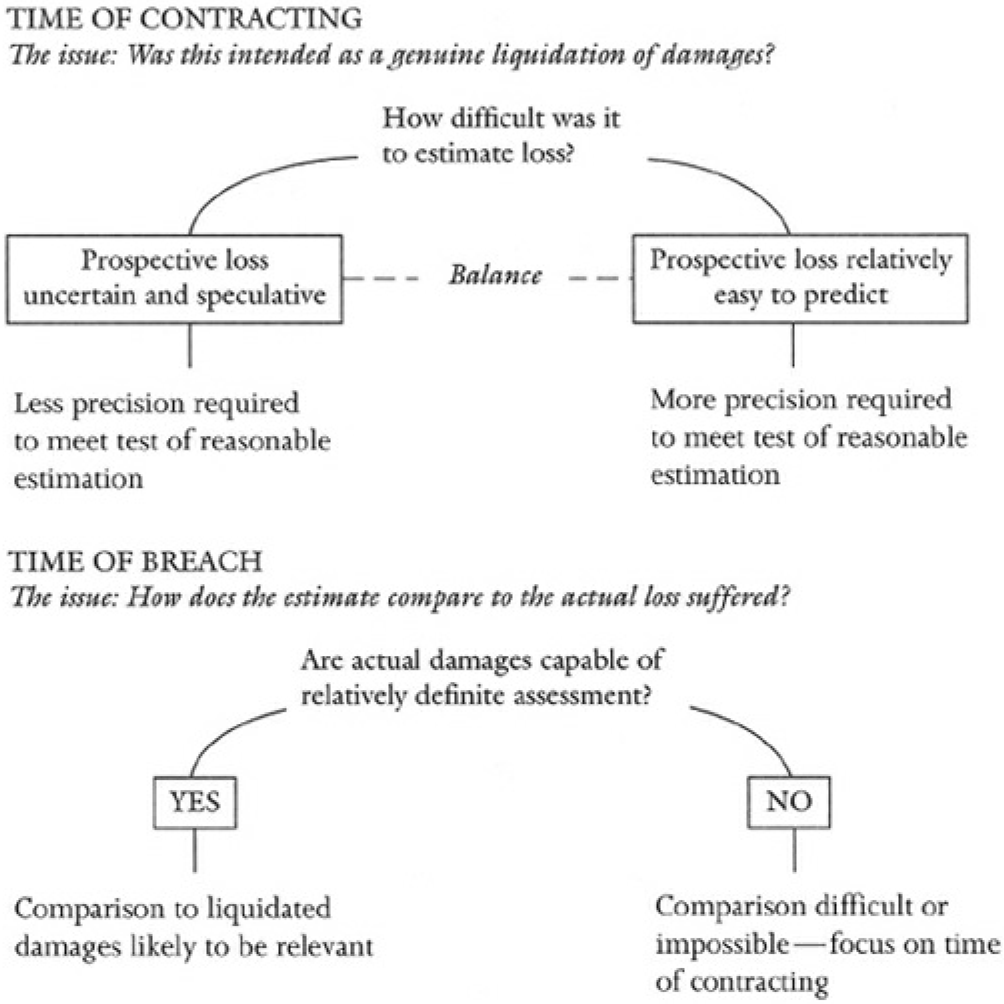
In *Barrie School v. Patch*, 933 A.2d 382 (Md. App. 2007), and *National Service Industries, Inc. v. Here To Serve Restaurants, Inc.*, 695 S.E.2d 669 (Ga. App. 2010), the courts noted that because the parties agreed to the liquidated damages provision when they entered the contract, there is a presumption in favor of its validity, so the party seeking to overturn the provision bears the burden of showing that it is a penalty. However, in *National Service Industries* the court also observed that in a doubtful case, the clause should be construed as a penalty. (The facts of both of these cases are discussed in section 18.11.2.)

The distinction between enforceable liquidated damages provisions and unenforceable penalties is difficult to draw because of the uncertainty inherent in any prediction of probable loss. The mere fact that the contract stipulates that the liquidated damages are a genuine pre-estimate of harm is not in itself dispositive. In fact, it must be regarded with some skepticism because the parties, knowing that penalties are unenforceable, are not likely to call it a penalty in the contract. Therefore, the purpose of the clause must be gleaned by interpretation in context to determine its true intent and effect. Some courts look only at the circumstances existing at the time of contracting and ask only whether the liquidated damages are reasonable in light of the anticipated harm. Restatement, Second, §356 and UCC §2.718, in almost identical language, adopt a broader, two-point test that asks whether the amount fixed as damages is reasonable in light of the anticipated or actual harm caused by the breach. This formulation provides an alternative two-point test that validates the provision if it either was a reasonable forecast of harm at the time of contracting, or turned out to be reasonable in light of the actual damages suffered.

This two-point test seems to work as follows: The court should focus first on the question of whether the parties made a reasonable forecast of harm at the time of contracting. If they did, the court should defer to their genuine effort to settle damages in advance and uphold the clause, even if the actual damages suffered turn out to be higher or lower than predicted. However, even if the provision was not a very careful effort to predict damages and would fail the test of reasonable forecast, if the amount of liquidated damages ends up being reasonably close to the actual damages suffered, the provision should be upheld. (Of course, if actual damages can be proved, and they are about equal to the liquidated damages, there is not much benefit in having the liquidated damages provision, but it could make it easier for the party to establish the amount of loss.) Notwithstanding that the test is formulated in the alternative, a court may decline to enforce a liquidated damages clause, even though it was a genuine effort to fix damages in advance, where it is shown that the prediction of likely damages was very wrong. That is, even if the forecast of harm was reasonable at the time of contracting, a court may balk at enforcing it if it turns out that actual harm is much less than anticipated. It is also worth noting that the two-point test cannot be applied in all cases because the comparison with actual damages is possible only in cases where actual damages can be shown with reasonable certainty. If they are too difficult to prove, there will be no information on which to base this comparison, so the court will have to focus on the test applicable to the time of contracting.

The balancing of the considerations to be weighed in deciding on the validity of a liquidated damages provision is represented in Diagram 18G.

Diagram 18G



§18.11.2 The Evaluation of the Parties' Forecast of Harm

To decide the reasonableness of the anticipation of harm, the court must consider two factors: the expected difficulty of proving loss and the degree to which the estimate of harm was a reasonable advance estimate of that loss—a principled and genuine attempt to predict likely loss. On their face, these two factors appear contradictory because the more difficult it is to prove loss, the harder it must be to make any kind of reasonable pre-estimate of damages. However, the factors are not treated as rigid co-equal requirements, but as flexible considerations to be balanced against each other. Therefore, the more uncertain and speculative the damages, the less rigorous the court will be in examining the reliability of the pre-estimate. However, if anticipated damages would be relatively mechanical and routine, the parties are held to a stricter standard in trying to estimate them. For example, if the contract relates to an innovative new business venture, it will likely be difficult to prove damages for breach with reasonable certainty, so the court should give more deference to the parties' reasonable effort to fix a plausible amount of agreed damages based on the best estimations that they can make in light of the uncertainty. However, if the contract involves the sale of property for which there is an active market, substitutionary damages are usually quite easy to prove, so the parties' means of determining the amount of agreed damages must be more rigorously examined.

Two cases illustrate how courts may go about balancing the factors of reasonable forecast and difficulty of proof. In the *Barrie School* case, cited in section 18.11.1, the parents of a student agreed, upon enrolling their child in the school, that if they withdrew her after a certain date, they would be liable to the school for the full year's tuition. When they withdrew the child after the stated date and refused to pay the year's tuition, the school sued them for the unpaid portion. The court held that the undertaking to pay the full year's tuition was a valid liquidated damages provision because it was a reasonable pre-estimate of the likely harm that would be suffered by the school as a result of the withdrawal of a student, and that, given the school's budgeting process based on student count, it would be very difficult to estimate the loss of tuition in advance. The parents also argued that because the school eventually filled their daughter's place, the earnings from the substitute transaction should be deducted from damages. The court rejected this argument. It held that because the forecast of harm at the time of contracting was reasonable, it did not matter that the actual damages turned out to be less than the parties predicted. Therefore, because the valid liquidated damages provision fixed the amount of damages, the school had no duty to mitigate and the earnings need not be taken into account. A dissenting judge in this case criticized the majority for declining to take into account that the school ultimately suffered little or no damages because it admitted a student to take the place of the child who had been withdrawn. The dissent emphasized the compensation principle of contract law, and considered that it was wrong to enforce the liquidated damages provision where it manifestly overcompensated the school.

A provision in a contract to pay the balance of the contract price in the event of breach was not as well received by the court in *Lake River Corp. v.*

Carborundum Co., 769 F.2d 1284 (7th Cir. 1985). Carborundum, a manufacturer of ferro-carbo (an abrasive powder used in steelmaking), entered into a contract with Lake River under which Lake River would provide distribution services to Carborundum by bagging the ferro-carbo and shipping it to Carborundum's customers. Lake River had to install a new bagging system to perform this work, so it insisted that the contract contain a specified minimum tonnage and a three-year term. The contract provided that Carborundum would ship a specified minimum tonnage of ferro-carbo to Lake River, and even if it did not, would pay the contract price for that minimum tonnage. A downturn in steel production led to a reduced demand for ferro-carbo, and by the end of the contract term, Carborundum had shipped just over half of the minimum quantity to Lake River. Lake River sued for the balance of the contract price as provided for in the guarantee of minimum tonnage. The court (while expressing reservations over the wisdom of interfering with contract provisions fairly negotiated by sophisticated commercial entities, but considering itself bound by precedent on the issue) invalidated the clause as a penalty. This contract involved the rendering of a service, so Lake River's damages would be its lost profit, which is normally capable of proof by arithmetical calculation. Therefore, because the formulation of agreed damages did not take into account any costs saved by the breach, it would inevitably exceed Lake River's lost profit and its actual loss. The earlier in the period that the breach occurred, the greater the cost savings would be, and the higher the disproportion between realistic and agreed damages. Accordingly, the court held that the provision was not a reasonable forecast of harm, but was an unenforceable penalty.

Even where the parties do attempt to take costs into account in estimating lost profits, a court may find that the effort did not result in a reasonable forecast of harm. In *National Service Industries, Inc.*, cited in section 18.11.1, Here To Serve Restaurants (HTS) entered onto a contract with National Service Industries (NSI) under which HTS rented linens for its restaurants from NSI. HTS breached, and NSI sought damages under a liquidated damages provision in the contract. The provision stated that if HTS breached the contract, it would pay liquidated damages to NSI "in an amount equal to forty percent (40%) of the average weekly fees charged for service prior to the date of breach…times the number of weeks remaining in the unexpired term." Despite the fact that the provision expressly stated that it was not a penalty, but rather a reasonable estimate of difficult-to-prove loss, the court found it to be a penalty. NSI's chief financial officer had testified that the 40 percent formula reflected its anticipated lost profits, calculated by deducting its actual historical direct costs from the contract price. However, the formula was an historical average of all NSI's contracts (and used in all its contracts), even though there were variations in the actual profitability of particular transactions. In addition, there was no evidence that NSI would be unable to secure a replacement contract to offset the profits lost as a result of the breach of this one.

§18.11.3 Damage Limitation Provisions

A term limiting damages must be distinguished from an agreed damages provision. The purpose of a damage limitation is not to forecast harm and settle the amount of the loss in advance, but to place a limit on the relief that a party may claim in the event of breach. A common example of a damage limitation is a term stating that a party will not be liable for any consequential damages arising from the breach. This provision does not anticipate the amount of damages, but rather precludes a claim for any consequential damages and confines liability to direct damages.

A provision in a contract that fixes agreed damages in an unreasonably small amount is, strictly speaking, a liquidation of damages rather than a damage limitation. It would therefore be rational to assume that it should be analyzed as described in sections 18.11.1 and 18.11.2. However both Restatement, Second, §356 and UCC §2.718 focus on the penal nature of unreasonably large liquidated damages and do not seem to encompass unreasonably small liquidated damages. (In fact, Comment *d* to §356 states that the section is not applicable to a term that fixes damages in an unreasonably small amount.)

If a term is classified as a damage limitation, it is treated differently from a liquidated damages provision and it is not subject to the tests discussed above. Instead, Restatement, Second, §356, Comment *a*, UCC §2.718, Comment 1, and UCC §2.719 indicate that damage limitation provisions are enforceable unless they are unconscionable. A limitation of remedy that grossly undercompensates the victim of a breach and deprives her of meaningful relief could, of course, be substantively unconscionable. However, as the discussion of unconscionability in section 13.11 explains, a finding of unconscionability requires more than a harsh result. There must also be some evidence that the unfair term resulted from procedural unconscionability—that it was imposed on the plaintiff by improper bargaining. In addition to avoidance on grounds of unconscionability, §2.719 permits the nonenforcement of a limitation of damages where circumstances have caused the limited remedy to fail of its essential purpose. Therefore, even if the elements of unconscionability are not satisfied, a damage limitation can be disregarded if it is clear that it badly undercompensates the plaintiff or provides for a remedy that is valueless.

§18.12 INCIDENTAL DAMAGES, ATTORNEY'S FEES, AND INTEREST

In addition to the principal remedies discussed above, there are ancillary monetary awards that are often needed to fully compensate the plaintiff for a breach of contract. They are noted briefly here.

§18.12.1 Interest

When a contract itself provides for the payment of interest on an amount due by a party, the claim of interest is simply part of the plaintiff's damage recovery and is included in the claim. For example, if a lender makes a loan and the borrower breaches the contract by failing to repay it, the lender is entitled to sue for both the principal and for the full amount of accumulated interest at the rate provided in the contract. Interest continues to accrue until the debt is paid.

Even when the contract does not provide for the payment of interest, the general rule is that a plaintiff may recover interest on a performance with a fixed or ascertainable money value from the time that the performance became due to the time that payment is ultimately made. Even when damages are uncertain until finally fixed in the judgment, interest is commonly awarded to the plaintiff from the time between when the judgment was rendered and its ultimate payment.

§18.12.2 Incidental Damages

It is worth stating again that incidental damages, as described in this section, are different from and bear no relationship to incidental reliance damages discussed in section 18.8.3. Incidental damages are those expenses reasonably incurred by the plaintiff after the breach in attempting to deal with the breach. They are essentially the administrative costs of coping with the breach and taking whatever action is necessary to protect and enforce the plaintiff's rights under the contract. They include such items as the costs incurred in making arrangements to obtain substitute performance and to mitigate damages. For example, say that the buyer of goods breaches the contract by refusing to accept the goods when the seller tenders delivery. As a result, the seller has to transport them back to a warehouse, store them, and negotiate for their resale. All the additional costs of transport, storage, and negotiation are incidental damages and may be recovered by the seller, provided that they were incurred reasonably. (As this example involves a sale of goods, incidental damages are defined in UCC §§2.710 and 2.715, but they are also available under common law.)

Although incidental damages do, in a sense, follow as a consequence of the breach, they are distinguishable from and should not be confused with consequential damages: They do not arise as a result of the impact of the breach on some other transaction or activity dependent on the contract, but are expenses directly related to the plaintiff's attempt to manage the effects of the breach.

§18.12.3 Attorney's Fees

Based on the above definition of incidental damages, one might assume that the plaintiff should be able to recover her attorney's fees incurred in suing to enforce the contract after breach. They are, after all, expenses that the plaintiff was forced to undertake in dealing with the breach and seeking to enforce her rights under the contract. Despite this, attorney's fees are not usually recoverable by the winner of a lawsuit unless the contract specifically allows them, they are authorized by statute, or the case falls within one of a few narrow categories of exception recognized at common law. The common law exceptions apply to bad faith and vexatious litigation and to other specific situations that need not concern us here. There is no statute that generally provides for the recovery of attorney's fees in contract cases (but individual states may have statutes that allow fees in certain types of contract suit). Therefore, the general rule is that attorney's fees are not recoverable by the winner of a suit on contract unless the contract itself makes provision for this.

The United States is one of the few countries in the world in which the prevailing party in litigation is not routinely entitled to recover attorney's fees from the loser. The debate over the merits of this approach is complex and beyond our scope. It is important to recognize, however, that unless one of the exceptions to the general rule applies, our system, by not reimbursing the plaintiff for the considerable expenses of litigation, does not really achieve its goal of placing the plaintiff in the position she would have been in had the contract been performed.

In tort cases, where a jury has a fairly wide discretion in deciding on the amount of noneconomic damages (such as those awarded for mental distress or pain and suffering), it has some ability to increase the plaintiff's compensatory damages to take account of attorney's fees. If the case merits punitive damages, overcompensation may go far beyond this. By contrast, because contract damages are focused on provable economic loss, the jury has much less flexibility to inflate the award to cover the plaintiff's attorney's fees. This difference in approach between contract and tort can be justified on the basis that, unlike a tort victim, a contracting party is capable of providing in the contract for the award of attorney's fees (if she has the bargaining power to do so).

§18.13 NONECONOMIC AND PUNITIVE DAMAGES

§18.13.1 Mental Distress and Other Noneconomic Loss

Because contract damages are geared to economic loss, they do not typically take account of any mental distress, inconvenience, humiliation, or other noneconomic harm caused by the breach. This principle is applied firmly, whether the aggrieved party is a corporation without heart or soul, or some poor individual who really is traumatized and distressed by the breach. For example, in *Chrum v. Charles Heating & Cooling, Inc.*, 327 N.W.2d 568 (Mich. 1982), a furnace bought from the defendant caught fire and destroyed the plaintiff's home. The court refused to award damages for mental distress because the contract was simply a commercial transaction, the breach of which led to property loss. *Valentine v. General American Credit,* 362 N.W.2d 628 (Mich. 1984), took the same approach where an employee claimed mental distress damages for wrongful discharge. The court recognized that the breach of an employment contract has a negative emotional effect on the employee, but the contract is commercial in nature, and compensation must be confined to any provable economic loss. (Note, however, if the employee was wrongfully discharged in violation of a statute that, say, protects employees from discrimination, the statute itself may allow for both compensatory and noncompensatory damages.)

Courts have recognized exceptions to this rule in two situations. First, if the breach of contract is also a tort, the tortious nature of the breach permits compensation for whatever noneconomic damages the plaintiff suffered. However, this is not really much of an exception at all, because a tort was committed, and the noneconomic damages are linked to the tort. Courts usually require that the tort be an independent tort—that is, the breach of the contractual obligation must be one that would give rise to liability for the breach of a duty recognized as actionable under tort law. Therefore, a mere negligent (or even intentional) breach of contract is not the basis for noneconomic damages unless the plaintiff can show that the conduct of the breacher is also a violation of the duty of care required under tort law. For example, if a surgeon negligently performs an operation, thereby both breaching a contractual duty of competent performance and committing the tort of battery, the patient can recover not only any economic losses but also damages for pain and suffering and emotional harm. The court recognized this in *Chrum*. After concluding that the contract did not involve the kind of personal interests that merited mental distress damages, the court said that the plaintiff would be able to sue in tort for mental distress if the defendant had negligently breached its duty of care in installing the furnace. It remanded the case to allow the plaintiff to pursue a tort claim.

The second exception concerns contracts whose clear and principal purpose is not to satisfy any economic or commercial goal of the plaintiff, but to give her an emotional, sentimental, or psychic benefit. It is the nature of the contract, not the nature of the breach, that is crucial.[17] Courts that recognize this exception usually apply it very narrowly to contracts that so deeply involve matters of personal concern to the plaintiff that her noneconomic purpose is clear and the defendant must reasonably have realized that a breach would likely inflict serious emotional distress on her. In refusing relief for the breach of the commercial contract in *Chrum*, the court cited cases in which breach appropriately gave rise to mental distress damages—a nursing home's breach of a caregiving contract by failure to notify the plaintiff of her mother's pending death, and a funeral home's breach of a burial contract by mutilating the body of the plaintiff's daughter. Breaches of contracts for funeral services feature quite regularly as the basis for awarding mental distress damages. For example, in *Menorah Chapels at Millburn v. Needle*, 899 A.2d 316 (N.J. Super. A.D. 2006) (discussed in section 17.6.3 in relation to divisibility), the court held that the plaintiff was entitled to mental distress damages where the funeral home breached the contract to perform funeral services by failing to ensure a proper vigil over the body in accordance with orthodox Jewish ritual. Breaches of contracts for wedding services are sometimes treated as the kind of contracts that merit an award of mental distress damages. In *Dietsch v. Music Co.*, 453 N.E.2d 1302 (Ohio 1983), a band that failed to show up for a wedding was held liable for emotional distress damages. However, other courts have not allowed newlyweds to recover damages for the emotional trauma caused by a botched wedding. In *Zumwalt v. Kevin Lee Collections, Inc.* 2008 WL 5159127 (Cal. App. 2008), a wedding planner promised the plaintiffs (the bride and her mother) that he would provide a wedding that would be a "first-class dream event" and would have "elegance with a chic Hollywood vibe." The wedding, which cost $97,000, fell far short of promised expectations. Among other things, the planner did not show up to supervise the event, the food was poor and badly served, and the planner did not provide a chocolate fountain or Veuve Cliquot champagne, as promised. The court of appeals reversed the trial court's award of emotional distress damages. Although it acknowledged that a wedding has a strong emotional focus for the bride and groom, it found the production of a wedding to be nothing more than a commercial contract for food, catering, and food service. The court said that it is more closely analogous to the construction of a home than to the provision of funeral services.

When courts consider the propriety of awarding mental distress damages, they usually couch the discussion in terms of foreseeability and ask whether the nature of the contract was such that the parties reasonably contemplated that its breach would lead to mental distress. For example, in *Menorah Chapels*, the court pointed out that because a contract for funeral services is designed to bring comfort to the bereaved, the chapel could readily foresee that its breach would cause emotional distress. However, while foreseeability of the emotional damage is an important factor in deciding whether to award mental distress damages, it must be stressed that the contemplation of possible mental distress is not enough. The sentimental or emotional character of the contract performance is crucial. In *Valentine*, the court recognized that an employer can readily foresee that wrongful dismissal will cause an employee mental distress. However, because the contract is commercial in nature, that foresight is not enough to entitle the employee to mental distress damages.

§18.13.2 Punitive Damages

The purpose of punitive damages is to punish the defendant for particularly egregious conduct and to deter her from similar conduct in the future. Because the punishment of the defendant is also likely to make an example of her and thereby have a deterrent effect on others, punitive damages are also sometimes called exemplary damages. Punitive damages are principally available in tort law. They are not appropriate when the tort involves ordinary negligence and are confined to cases in which the defendant deliberately and maliciously injured the plaintiff, or sometimes when the defendant acted in callous and conscious disregard of the plaintiff's rights. Although punitive damages are aimed at punishing the defendant, they are not in the form of a fine payable to the public treasury but are awarded to the plaintiff in addition to whatever she is entitled to as compensatory damages. They are therefore a windfall that has the effect of overcompensating her. Because punitive damage awards can be large, the degree of overcompensation can be astounding.[18] Even in the area of tort law, where the jury's discretion to award punitive damages in appropriate cases is well established, a jury may be overzealous in setting the amount of punitive damages, so that the judge has to reduce the award.

As emphasized many times in the preceding pages, the orientation of contract law is to the compensation of the plaintiff's economic loss, not to the punishment and deterrence of breach. As a result, it has long been seen as inappropriate to augment any compensatory award by punitive damages, even when the breach was deliberate and faithless. Restatement, Second, §355 reflects this attitude by taking the position that punitive damages are not recoverable for a breach of contract unless the breach consists of tortious conduct for which punitive damages would be available under tort law.

Where punitive damages are awarded for breach of contract, it is almost always because the defendant's conduct constitutes both a breach of contract and a deliberate, independent tort. This is illustrated by *America's Directories, Inc. v. Stellhorn One-Hour Photo, Inc.*, 833 N.E.2d 1059 (Ind. App. 2006), a fraud case discussed in sections 12.12 (the fraud exception to the parol evidence rule) and 13.6.2 (fraudulent promise). Recall that the seller of advertising in a phone directory made a fraudulent promise that it would permit the buyer to cancel the advertising after the first year of the three-year contract. The court upheld the jury's award to the buyer of both compensatory damages (for work and time lost in trying to deal with the fraud) and punitive damages. The court noted that in addition to violating the plaintiff's contract rights, fraud is independently recognized as a tort, and there was sufficient evidence for the jury to conclude that the seller committed the tort willfully and wantonly by intentionally misleading the buyer.

In a narrow range of cases, particularly involving an insurer's willful breach by unjustifiably failing to indemnify the insured promptly, adequately, or at all for loss covered by the policy, courts have been willing to award punitive damages even though tort law has not traditionally recognized the breach as an independent tort. (Some courts have overcome this barrier by creating a new tort, so that an egregious violation of the duty of good faith and fair dealing is recognized as a tort in itself.) Insurance policies are contracts of adhesion,[19] and the failure to indemnify the insured can have disastrous consequences for him. If an unscrupulous insurer deliberately fails to indemnify the insured until it is sued, the ultimate award of nothing more than compensatory damages is not likely to be much of a deterrent to future conduct of this kind. Therefore, punitive damages serve the purpose of increasing the risk of such behavior and may better dissuade the insurer from trying to evade its obligations. Although there are other types of contracts in which it may be appropriate to award punitive damages for bad faith breach, courts have not readily expanded this doctrine beyond the field of insurance.

§18.14 A TRANSNATIONAL PERSPECTIVE ON REMEDIES

The CISG sets out the buyer's rights generally in Articles 45 to 46 and the seller's rights generally in Articles 53 to 59. It provides for damages in Articles 74 to 77. The UNIDROIT Principles cover remedies in Articles 7.2.1 to 7.4.13. It is beyond the scope on this short note on perspective to examine in detail the remedial provisions of the CISG and the UNIDROIT Principles. In general, although there are differences, many of their remedial concepts are equivalent to those set out in this chapter. For example, they expressly or impliedly recognize that the principal purpose of damages is to give the injured party the benefit of the bargain, commonly measured by the difference between the contract price and the cost of a substitute transaction or the market value of the performance. They also recognize that lost profits may be the appropriate measure of damages in some cases. They require that damages be proved with reasonable certainty, be reasonably foreseeable, and be reasonably mitigated.

There are some notable differences from the common law. Neither the CISG nor the UNIDROIT Principles follow the common law's firm preference for damages over specific performance, which derives from the distinction between legal and equitable relief that is peculiar to the common law. However, Article 7.2.2 of the UNIDROIT Principles does exclude the remedy where it would be unfair or impractical—for example, where it is unreasonably burdensome or the performance is of an exclusively personal character. Article 7.4.2 of the UNIDROIT Principles deviates from the common law by allowing nonpecuniary damages for breach of contract, including damages for emotional distress. Although the CISG does not address agreed damages, Article 7.4.13 of the UNIDROIT Principles adopts a more liberal approach to agreed damages than the common law and generally upholds them irrespective of the actual damages suffered.

Examples

1. Cliff Blaster owned a piece of land on which he planned a residential development. There was a large rock outcrop on the land that was an obstacle to developing the land, and he wished to demolish it. He entered onto a contract with Dinah Mite under which Dinah agreed to demolish the outcrop for a price of $500,000, to be paid after completion of the demolition. (Following destruction of the outcrop by Dinah, Cliff would clear the rubble and use it in the construction of the development.) Shortly after the contract was executed, Dinah bought

explosives at a cost of $100,000 to perform the work and she began to rig the rocks for demolition. After entering into this contract, Cliff discovered that zoning regulations precluded any development of the property. The day before Dinah was due to detonate the explosives, Cliff contacted her and terminated their contract. Dinah told Cliff that he had no legal right to back out of the contract, and she refused to accept the termination. On the next day she proceeded with the detonation and successfully demolished the outcrop. She then claimed the contract price of $500,000 from Cliff. Assume that Dinah was correct in stating that Cliff had no right to terminate the contract. By doing so, he materially repudiated it. Nevertheless, had she accepted the reality that Cliff had breached and the contract was at an end, she would have been able to return the explosives to the seller or to use them in future jobs. She had already incurred other expenses of $20,000 up to the time of Cliff's breach, but would have avoided additional costs of $5,000 involved in the process of demolition. Can Dinah claim the contract price from Cliff? If not, what, if anything is she entitled to claim?

2. Buddy Beautiful is a celebrated supermodel, best known for his extremely seductive advertisements for men's fragrances and designer denim jeans. He decided to capitalize on his fame by becoming a movie star. Following intensive negotiations, his agent managed to secure a contract for him with Medea Mogul, an important movie producer. In terms of the contract, Buddy would be paid $10 million for taking the lead role in a movie to be called *Buddy's Big Budget Adventure*, an expensive and riotous new comedy, full of cute jokes and romantic scenes in which Buddy would have the opportunity to remove some or all of his clothing. Production of the film was to begin two months after the contract was signed, and would last for six months.

   About a month after entering the contract, Medea decided not to produce the film. She wrote to Buddy, informing him of the film's cancellation and offering him the leading role in another movie called *Hamlet* that would be produced instead during the same period. Although Medea assured him that this film would do his career far more good than *Buddy's Big Budget Adventure*, Buddy was unconvinced. He read the script, which was written in strange, complicated, old-fashioned language. It was difficult to follow and would be even harder to learn. From what he understood of it, it also seemed very sleazy and definitely

"R" rated. It was about this dysfunctional Danish family whose members are rather lacking in traditional family values and are heavily into sex and violence. The character to be played by Buddy talks too much, never has any fun, and does not conform to the sexy, but cute and wholesome image Buddy wanted to project. Furthermore, in her letter Medea described *Hamlet* as an "art film," which apparently meant that its box office draw would be small. As a result, the letter regretted to inform him, his fee for starring in it would be only $5 million.

Despite his misgivings, Buddy decided that *Hamlet* was better than nothing, so he accepted the offer. Does he have any claim for damages against Medea? If so, how much?

3. Change the facts of Example 2 as follows: Buddy did not feel that Hamlet was a suitable role, so he declined Medea's offer and insisted that she make the original movie as promised. Medea refused and their relationship broke down. Buddy put his agent to work seeking other movie opportunities. Despite a year's conscientious and persistent effort, the agent was unable to secure any film roles for Buddy. In the interim, Buddy declined several offers of modeling jobs because he felt that he should hold himself available to perform whatever new film contract his agent should find. What damages, if any, should Buddy receive?

4. How would your answer to Example 3 change if two weeks after Medea's repudiation, Buddy entered into a contract with Dee Ziner, a designer of men's fashions, to model her new line of summer clothing? Buddy's performance under the modeling contract began immediately after execution of the contract and lasted one month. Buddy earned a fee of $1 million.

5. Because Buddy's agent could not find another film contract for him, his hopes for a movie career ended in failure. Buddy is convinced that had he made the comedy for Medea, he would have established himself as a star and enjoyed unlimited opportunities for further movies. He has now sued Medea for the $10 million payable under their contract, as well as $200 million in damages for the destruction of his movie career. Should he be awarded these damages?

6. Harpo C. Chord is a young and ambitious pianist. After struggling for many months to find work, he finally received an offer to play dinner

music at Trés Trendi, a fancy restaurant. This was not quite what he had in mind as a career opportunity, but his financial reserves were much depleted and he was becoming desperate. He also realized that because the restaurant was in the theater district, many of its patrons were influential in the arts, so there was a good chance that someone important might notice his talent and offer him something better. He therefore accepted the offer and on January 15 he entered into a contract with Trés Trendi under which he would play the piano during dinner from 8 P.M. to midnight every night for a month. His performances would begin on February 1, and he would be paid "the going rate" for his services. Because neither party knew at the time of contracting what the current market rate was for a dinner pianist, Trés Trendi said that it would make inquiries and tell Harpo as soon as it found out.

Having heard nothing from Trés Trendi for a week, Harpo called the manager to find out what rate of compensation had been established by the promised market survey. He was stunned when the manager told him that inquiries had shown that the market rate for a pianist was much higher than she had anticipated, so she had decided to scrap the idea of having live music in the restaurant. This is a clear repudiation of the contract, and despite Harpo's fervent pleas, the manager refuses to relent.

Having just gone through the agonizing process of looking for work, Harpo realizes that he has little chance of finding other employment for February. Besides, he wants to work for Trés Trendi so that he can showcase his talents to any useful diners that may be present. What recourse does he have?

7. Barney Sellers owned an acre of land in the suburbs. The land was once part of a farm that has long since been subdivided into smaller lots for housing. However, the original barn is still located on Barney's acre, which is otherwise vacant. When Barney retired last year, he decided to move from his home in the city to his suburban acre. He had plans drawn for a new house to be constructed on the eastern portion of his lot. The existing barn was on the western side of the lot, so it did not interfere with his building plans, but it was quite an unsightly structure and would occupy space that Barney wished to use as a garden. The barn was in reasonably good condition and was easily removable, so he decided to sell it instead of demolishing it. He advertised it for sale and

ultimately sold it to Penny Pincher for $5,000. In terms of the contract, Penny agreed to pay all the costs of removing the barn and also to break up its concrete foundation and remove the debris.

A few weeks later, Penny removed the barn. She was going to hire someone to break up and remove the concrete foundation, but when she discovered that the cheapest quote for the job was $7,000, she decided that it was a waste of money and refused to do it. The existence of the concrete slab will spoil Barney's landscaping plans and leave him with a useless and ugly concrete surface in his backyard. However, because suburban land is scarce and of prime value, the presence of the slab would apparently not dissuade a typical buyer from purchasing the property at its full worth. As a result, the removal of the slab would not enhance the property's market value. What damages, if any, can Barney recover for Penny's breach?

8. To satisfy the demand for its required course on professional ethics, a law school offers a summer school ethics course every year. The course is usually in great demand and attracts about 50 students each summer. Last November, the law school contracted with Bill A. Billhours, a prominent local attorney, to teach the summer ethics course for a fee of $10,000. The contract obliged him to teach four evenings a week for five weeks, beginning on June 1. On May 15, Bill was given the opportunity of advising a new client in connection with a huge international transaction. Participation in the proposed transaction promised to be both stimulating and lucrative, so Bill grabbed the chance of working on it. Unfortunately, the work required him to be out of the country for much of June and July, so it was no longer possible for him to teach. He called the dean of the law school on May 17 and told him that he could not teach summer school as planned.
   a. Not wishing to disappoint the students who were relying on taking the course that summer, the dean immediately set to work finding a replacement. After making several unsuccessful calls, she was finally put in touch with Professor Wise, a world-famous expert on legal ethics and the author of several definitive books on the subject. Professor Wise had just retired, so he had no plans for the summer, but he was unwilling to teach for less than $15,000, plus his traveling and living expenses, which amount to a further $4,000. Desperate, the dean agreed to his terms. Can the law school recover all or any of the

$19,000 from Bill?

b. Assume that the dean was unable to find anyone to teach the course because it is too late to find a teacher on such short notice. The dean cannot bear to let down all those students who are relying on taking the course during the summer. Is there anything she can do to force Bill into teaching?

c. Assume that the dean can neither find a substitute teacher nor compel Bill to teach. As a result, the summer ethics course has to be canceled. Based on enrollment before cancellation, the law school can show that it would have made $75,000 in tuition from the course. In addition, the law school was sued by one of the students who had enrolled in the course. The student had been relying on the course to complete his requirements for graduation in the summer so that he could graduate in August. He had a job beginning in August, but now he cannot begin work until after he graduates at the end of December. He therefore claimed three months' salary from the law school. To avoid adverse publicity and a negative impact on alumni relations, the law school paid the student's claim. What recourse, if any, does the school have against Bill?

9. Nat Atorium hired La Goon Pool Co. to build a swimming pool in his backyard. As the yard was small, the pool had to be placed not more than five feet from the rear wall of the house. La Goon brought its excavating equipment into the yard and one of its workers began to dig the hole. After spending some hours on the job and having excavated to a depth of about six feet, the operator started to become weary and careless. As a result, he dug too close to the house, undermining its foundation and causing the rear of the house to collapse. At the time, Nat was in one of the rear rooms and he could have been severely injured or killed had he not had the presence of mind to dive out of a door just as the room began to cave in. Although he escaped physical injury, he was badly traumatized by the close call and the destruction of half his house.

This experience has removed Nat's desire for a swimming pool. La Goon concedes that it is liable for the cost of repairing Nat's house, the fair market value of all personal property lost in the collapse, and the cost of filling in the hole and restoring the yard. However, Nat says this is not enough. He demands in addition:

a. Compensation of $150,000 for the shock and distress that he suffered as a result of La Goon's incompetence.
b. Compensation of $50,000 for the loss of irreplaceable family records and photographs that were among the personal property destroyed. Although they have no economic worth, they were of immense sentimental value to Nat.
c. Punitive damages of $1 million.

Is Nat likely to succeed on any of these further claims?

10. Chic Canery has managed to train a troupe of chickens to perform amazing tricks. She has appeared on several TV shows with them and has attracted a lot of public attention. AC9 Productions, Inc., a show promoter, decided the market was ready for a live show featuring Chic and her chickens. It approached Chic with a proposal to produce such a show. Following negotiations, in January Chic and AC9 entered into a contract for the production of a show on July 4. The show was to be staged in a sports stadium with a capacity of 100,000 seats. AC9 would make all arrangements for the show and would be entitled to all proceeds from the event, save for a fee of $1 million to be paid to Chic. An advance of $100,000 on this fee would be paid to Chic on the signing of the contract, and the balance would be paid a week before the show.

Immediately after the contract was signed, AC9 paid the $100,000 to Chic and it began preparations for the show. It booked the stadium, hired a special staff to work exclusively on publicity and sales, and committed itself to the purchase of television advertising. On March 1, Chic changed her mind about doing the show and she repudiated the contract. After trying unsuccessfully to convince her to recant, AC9 had no choice but to accept the fact that Chic would not perform. As the theme and concept of the entire show were built on Chic's unique chicken act, it was too late to begin afresh by changing the theme and trying to find a new starring attraction. AC9 stopped all further work on the show and laid off its special staff. It exercised its cancellation right under the contract with the stadium and terminated its booking, forfeiting a $50,000 deposit. It had no right to cancel the television advertising slots. At the time of Chic's repudiation, AC9 had incurred the following expenses and commitments:

a. Before making a final decision to enter the contract with Chic, it had spent $30,000 on a market analysis and profit projection for the show.

b. It paid the $100,000 advance to Chic.

c. It paid $25,000 in salary and severance pay to its special staff.

d. It forfeited its $50,000 deposit on the stadium.

e. It committed itself to pay $500,000 for television advertising.

According to the market analysis and projections made by AC9 before it entered the contract with Chic, it expected the show tickets to be sold out, generating income of $5 million. It expected further earnings of $3.5 million from the sale of T-shirts, souvenirs, and food. Its projected costs, including Chic's fee, were $5.5 million, so it expected a profit of $3 million. What damages is it likely to recover from Chic?

11. Benny Fishery Co. entered into a contract with Reliant Renovations, Inc. under which Reliant agreed to build an addition to Benny Fishery's seafood processing plant. The contract required Reliant to excavate the site, build a foundation, and erect an aluminum structure on it. The total price for the project was $230,000. Reliant began work and encountered trouble immediately because the ground was much rockier than expected. As a result, it had to hire a subcontractor to blast the rock and had to use much heavier equipment than anticipated. This greatly increased its costs of excavation from an expected $50,000 to $100,000, and its total projected cost from $200,000 to $250,000. This meant that it now projected a loss of $20,000 on the contract. However, Reliant greatly values its reputation for keeping its commitments, so it did not try to renegotiate the price or to claim relief for mistake. Instead, it decided to bear the loss and complete the job for the contract price.

    Soon after the excavation had been completed and before Reliant could proceed any further, Benny Fishery decided that it no longer needed the addition to its plant. It terminated the contract. As it had no right to do this, the termination was a total breach. The excavation work constitutes exactly one-quarter of Reliant's performance under the contract, and Benny Fishery has therefore offered to pay Reliant $57,500, which is exactly one-quarter of the contract price. Should Reliant accept this payment or demand more?

12. Gracie Spooner owns a busy hamburger joint. She recently decided to replace her grungy ketchup pumps with little plastic sachets of ketchup.

To ensure a ready and stable supply of this vital ingredient in her cuisine, she entered into a one-year contract with Sauce Source, Inc., a wholesaler. Under the contract, Gracie committed herself to buy a minimum of ten boxes of sachets a month, at a price of $25 a box. The contract contained the following provision:

> The parties record that the pricing of the product sold under this contract is based on Buyer's commitment to take the minimum quantities specified above. Therefore if Buyer should breach this contract by failing to take the prescribed minimum quantity, Seller shall be entitled to damages based on the difference between the total amount actually bought and paid for by Buyer during the contract period and the total minimum price payable for the contract period. The parties expressly agree that this provision does not constitute a penalty, but is a genuine attempt to estimate damages and to avoid the uncertainty and difficulties of proof.

Gracie bought and paid for the minimum quantities required by the contract for seven months, but she found that she had grossly overestimated the amount of ketchup that she needed. Unopened boxes of sachets were beginning to pile up in her small storeroom, and it was clear to her that she already had enough ketchup to last her for more than a couple of years. She therefore declined to order or accept delivery of any more ketchup from Sauce Source. When the yearlong contract period ended, Sauce Source sent an invoice to Gracie for $1,250, based on the price of the minimum quantity that she had failed to take during the last five months of the contract. Gracie protested to the manager of Sauce Source. Gracie pointed out that ketchup had gone up in price since they made their contract, and she suggested that Sauce Source simply sell the remaining boxes at a better price to someone else. The manager told her that they had enough ketchup to keep all their customers supplied, with plenty over, so her breach actually reduced their volume of sales for the year. In any event, he reminded her that she did agree to this payment in the contract. Gracie feels that the invoice is ridiculous. Should she pay it?

Explanations

1. Cliff had no right to terminate the contract, so his termination was a material repudiation[20] that would entitle Dinah to claim expectation damages from him. Had Dinah fully performed before the repudiation, it would have been appropriate to award her the full unpaid balance of the

contract price. She expected to receive that price, and there would have been no deduction from it because she would not have saved any costs as a result of the repudiation. Stated differently, where a party has incurred the full cost of performing before the other party's repudiation, her contractual expectation is achieved by reimbursing the costs she expended (her reliance loss) plus her expected profit. This amounts to the contract price. However, because the repudiation occurred before Dinah had fully performed, she is not entitled to receive the full contract price. At the time of repudiation, Dinah had incurred costs of $20,000 in performing, but had not yet detonated the $100,000 worth of explosives or incurred the $5,000 costs of the detonation itself. Therefore, at the time of breach, Dinah's expectation damages would have been $395,000, made up of her reliance expenses of $20,000 plus her lost profit of $375,000 (the price of $500,000 less the total expected costs of $125,000). By disregarding Cliff's termination and proceeding with the demolition, Dinah aggravated her damages by using up the explosives and incurring the additional costs of demolition. The mitigation principle precludes her from holding Cliff liable for her obstinately persisting in performance after Cliff had unequivocally repudiated the contract. She must therefore be confined to her expectation before she increased her damages.

This Example is inspired by *Rockingham County v. Luten Bridge Co.*, 35 F.2d 301 (4th Cir. 1929), an old case that remains one of the best examples of obstinate damage aggravation. The county breached its contract for the construction of a bridge by terminating the project and telling the contractor to stop work. The contractor disregarded the instruction and continued to build the bridge. It was held entitled to recover its anticipated profit as well as those losses incurred up to the date of breach, but was denied any compensation for expenditures made after the breach.

By the way, Dinah would not have had better prospects of recovery if she sued in restitution for the value of her services in blasting the outcrop. By continuing work after Cliff withdrew his authorization, she became an officious intermeddler. In addition, Cliff received no useful benefit from her services because the demolished outcrop has no value to him. In fact Dinah may have committed a tort and a crime by blowing up part of his property without his permission.

2. Buddy's acceptance of the offer to star in *Hamlet* could be seen as a modification of the contract. If it was, there is no issue of breach or damages—the parties have simply changed their terms. However, when one party seeks to substitute a performance different from that originally agreed, the circumstances are also consistent with breach combined with an offer of mitigation. It is important to distinguish an agreed modification from a breach, followed by acceptance of a mitigating contract. If the parties have agreed to modify the contract, there is no claim for damages. However, if one of the parties breaches, and then offers the other a substitute contract that is accepted, the victim of the breach has a claim for damages to compensate for the difference in value of the original and substitute contracts.

   In Buddy's case, the facts indicate that Medea breached and then offered a substitute in mitigation. This seems a more appropriate conclusion given Medea's attitude (she informed Buddy of her decision rather than seeking to negotiate a change) and Buddy's reluctant acquiescence. Since Medea terminated the contract before performance was due, this is an anticipatory repudiation. It is unequivocal, material, and total. (This issue is discussed in section 17.7.2.) Upon Medea's total breach, Buddy is entitled to sue for his lost profit under the contract, less any amount recovered in mitigation. (In an employment contract, lost profits are commonly equal to the full salary because employees usually do not have to incur costs to perform, but any earnings from substitute employment must be deducted from damages as mitigation.)

   Hamlet is surely a substitute contract, because Buddy would not have been able to do both films, which have the same production dates. (In fact, Medea's decision to produce the second was apparently based on her decision to cancel the first.) When, as a result of the breach, the plaintiff is released from his performance so that he can undertake other work that could not have been done in the absence of breach, any earnings from that other work must be treated as a gain from the breach and offset against damages. Therefore, his earnings from *Hamlet* ($5 million) must be deducted from his lost profit damages for the breach of the initial contract ($10 million).

3. Buddy has rejected the opportunity to reduce his damages by starring in *Hamlet* for $5 million. Because he could find no other substitute film contract, he has been idle for a year. It must therefore be decided if

Buddy's refusal of Medea's offer and his failure to perform other work was a violation of his duty to mitigate, resulting in aggravated loss for which Medea should not be held accountable. If so, there must be an offset against his damages of the $5 million that he could have earned from *Hamlet*, or of whatever other amount he should have earned by other substitute work in the period that would have been occupied by filming *Buddy's Big Budget Adventure.*

Buddy may have failed to mitigate by refusing the *Hamlet* role. It may seem outrageous to expect the victim of a breach to accept mitigation by dealing with the very person who breached the contract and caused the loss. However courts generally take the attitude that mitigation opportunities offered by the breacher should be evaluated under the same standards as other available means to reduce damages: If this means of mitigation is not unduly risky, burdensome, or humiliating, it does not call on the victim to waive any right to relief under the breached contract, and it provides the most reasonable means of reducing the loss, the victim must pursue it, or risk losing the right to claim any damages that could have been prevented by taking it. Because the breacher has already shown herself to be untrustworthy, the victim may have justifiable concerns about whether she will prove similarly unreliable in the substitute contract. However, the victim needs to show more than a general apprehension that the breacher might again renege. Notwithstanding, there is a different consideration that may justify Buddy in declining the *Hamlet* role. If he had the reasonable prospect of finding a more suitable movie, his decision to refuse the role and hold himself available for a better opportunity may be a rational judgment. The fact that no better offer came along does not defeat this argument. The injured party's judgment with regard to mitigation need only be reasonable, even if it later appears that it was wrong, or that a different decision would have been better.

Parker v. Twentieth Century-Fox Film Corp., discussed in section 18.6.3, held that an employee's duty of reasonable mitigation does not require her to accept work that is different and inferior to that provided for in the contract. Medea's offer of the role in *Hamlet* is clearly very different from that promised to Buddy under the contract, but is it inferior? Although *Hamlet* may be a finer piece of work than *Buddy's Big Budget Adventure*, the role of Hamlet could be inferior for Buddy's purposes. It does not have the same potential to showcase his talents, to reach his targeted audience, or to further his career goals. Note that inferiority is judged on the basis of the quality of the substitute work, and not by the mere fact that Buddy would be paid less for playing Hamlet. The difference in earnings can be compensated for by a damages award.

If Buddy's refusal of the role in Hamlet violated his duty to mitigate, he aggravated his damages by $5 million and his damages must be reduced accordingly. However, if he was justified in refusing the role, we still need to determine if he should have taken other action to reduce his loss. He did make considerable efforts to find another film role, but he may not have been reasonable in refusing to seek or consider modeling jobs. Although modeling is different from acting in a movie, this line of work is not necessarily inferior because it is a field in which he has achieved success and doing more modeling would likely not have a negative effect on his career goals. If Medea can show that Buddy did not act reasonably in declining the modeling work in the hope of another movie contract, his damages should be reduced by what he reasonably could have earned during the six-month period that became free as a result of the film's cancellation.

4. If Buddy should have accepted the Hamlet role, the answer does not change—the full $5 million that he should have earned, not just $1 million he actually earned, must be deducted from his damages. However, if his refusal of *Hamlet* was justified, the fee earned from the modeling job must be offset against the $10 million loss. The performance of the modeling job took place during the period reserved for the filming, and Buddy could not have accepted it and earned the modeling fee had Medea not breached the movie contract. It is therefore a substitute transaction and the $1 million fee is a gain that would not have been made but for the breach. (If Buddy incurred any direct costs to perform for Dee, those would be subtracted before his earnings are offset. But in the typical employment contract it is the employee's time and labor that are being contracted for, and he does not usually have to spend much in rendering that performance. As a result, the employee's direct costs are likely to be small or even nonexistent.)

Therefore, provided that Buddy's refusal of the *Hamlet* role was justified, he can claim damages for breach in the amount of $9 million—

his full contract salary of $10 million less the $1 million earned in mitigation. This has the effect of overcompensating him because he receives his full contract fee even though he worked only for a month. However, Medea cannot complain because the benefit of not having to work so hard for his money does not reduce Buddy's financial loss. As in Example 2, the issue of whether the modeling job is different or inferior does not come up where Buddy accepted the substitute work. It is only relevant if he declines a substitute transaction.

5. Buddy's claim for consequential damages is based on the theory that by losing his opportunity to star in *Buddy's Big Budget Adventure,* he was deprived of a successful movie career and lost $200 million. The mitigation issue would arise here again, because his failure to accept the Hamlet role may have precluded an opportunity to prevent this consequence. However, Buddy may argue that this consequential loss would have occurred whether or not he had accepted the Hamlet role, because *Hamlet* would not have advanced his career at all and may even have ruined it.

   It is arguable that a movie producer should reasonably foresee that her failure to produce an actor's first film—especially if it is planned as an expensive blockbuster—could have an adverse impact on his career and deprive him of future opportunities. However, even if this is so, the overwhelming barrier to recovery is the highly speculative nature of the claim. It is unlikely that Buddy could prove with any degree of plausibility that the proposed movie would have been successful and would have advanced his career. There are just too many imponderables: Would he have performed well? Would good judgments have been made about publicity and promotion? Would the public have been attracted to the film and to him? Would it have made enough money to make him desirable to other producers? More uncertainties could be listed, but the point is made. Even if he could overcome this burden of showing a probability that opportunities would have been created, a further level of uncertainty would be encountered in trying to decide if he would have been lucky and clever enough to use them to advantage. In short, he cannot even prove what would have happened had the film been made, let alone establish a monetary value of the loss. The consequential damages claim must fail under the principles of certainty and causation.

The difficulty in establishing quantifiable loss when the breach results in a lost opportunity for publicity and its consequent career advancement is shown by another case springing from the entertainment industry: *Ericson v. Playgirl, Inc.*, 140 Cal. Rptr. 921 (Ct. App. 1977). *Playgirl* contracted with Ericson, one of its centerfold models and an aspiring actor, to rerun his photos in its *Best of Playgirl* annual and to include him as one of the models on the annual's cover. When *Playgirl* failed to include Ericson on the cover, he sued it for consequential damages for breach of contract. He produced witnesses who testified generally on the benefits of publicity to an acting career and on the economic value of appearing on a magazine cover. The court found that *Playgirl* had breached the contract, but it awarded Ericson only nominal damages. The court accepted that as an abstract matter, exposure (forgive the double entendre) is valuable to an actor, but his evidence of loss was too generalized and nonspecific. Any economically adverse consequences of the breach were pure conjecture.

6. Although Harpo's remuneration has not been settled, this should not affect the validity of the contract, because the parties have agreed on a market standard for determining it. A contract for a reasonable fee, to be based on an objectively ascertainable standard, is sufficiently definite for enforcement.[21] If Harpo was not reasonably able to mitigate his loss by finding appropriate substitute employment, he will at a minimum be able to sue for what he would have earned under the contract (less direct costs saved, if any). To establish what this amount would have been, he would have to produce evidence of the market rate paid to a pianist of his experience for equivalent work in a restaurant of similar standing. Such evidence is apparently available. However, Harpo was expecting more than a mere month's employment. He was hoping to make contacts and to open opportunities by playing in the restaurant. Although unlike Mr. Ericson, whose case is discussed in Example 5, Harpo plans to keep his clothes on during performance, that example shows that it is difficult to establish measurable injury as a result of the loss of publicity. Therefore, an award of money damages would most likely cover only his direct damages and would fail to compensate him for speculative consequential damages.

   When a plaintiff can show that a monetary award cannot adequately achieve his expectation, he establishes one of the essential grounds for the remedy of specific performance.[22] To get the order, Harpo must satisfy the court, in addition to showing the inadequacy of the damages remedy, that the court's burden of supervision is outweighed by the need for the remedy and that the balance of the equities favor granting the order. In addition, when there is some indefiniteness in the contract terms, even if the indefiniteness is not serious enough to invalidate the contract, the court may confine the plaintiff to damages unless the terms can be clearly established to support a precise and comprehensible order.

The indefiniteness in the fee to be paid to Harpo should not be a bar to relief because the court can establish the fee by reference to the market. There may also be some lack of detail with regard to Harpo's working conditions, which would have to be resolved, possibly also by reference to customary or reasonable standards. The primary focus of the definiteness principle in this context is to ensure that the order specifies Trés Trendi's duties precisely so that it knows what it must do to comply with the order to avoid contempt of court. By fixing the payment due to Harpo and detailing his working conditions, the court should be able to formulate a clear order. An order compelling Harpo's employment by a possibly begrudging employer does entail some burden of supervision to ensure that he is paid and that he is not mistreated or subjected to harassment. However, this supervisory task is not particularly onerous or exceptional. In a case like this the court is not likely to appoint an official to oversee the employment. It would be up to Harpo, if he alleges a breach of the order, to move for an order calling on Trés Trendi to show cause why it should not be held in contempt of court. The court would then conduct a hearing to determine if Trés Trendi violated the order and to impose a sanction if it did.

The equities of granting relief favor Harpo, not only because a damages award cannot adequately compensate him for his uncertain consequential damages but also because Trés Trendi committed a willful breach and it suffers no undue hardship by allowing Harpo to play the piano in its restaurant for a fee that it would have to pay in any event as direct damages.

7. It is easy to identify the measure of damages required to place Barney in the position he would have been in had Penny not breached. It is the reasonable cost of demolishing the slab and removing the concrete

debris, apparently $7,000. However, the facts show that although damages of $7,000 would give Barney the equivalent of performance in compliance with the contract, the breach did not actually cause him economic harm if his loss is instead measured by the diminution in the value of the property on which the work was to have been done. This raises the issue of whether the proper basis for recovery is the cost of giving him what was promised (which is $7,000) or the actual reduction in his wealth (which is zero). Stated differently, when the cost of giving the plaintiff his contractual expectation exceeds his actual ultimate financial loss, should his damages be limited by that ultimate loss?

As discussed in sections 17.3.4 and 18.6.6, Barney is normally entitled to the full measure of his expectation damages. However, if Penny's breach was not material or willful and the cost of giving Barney his contractual expectation would be an unfair forfeiture, the court may confine relief to Barney's ultimate economic loss, measured by the diminution in market value resulting from the breach. Penny's breach was deliberate, and that on its own is enough to preclude application of the unfair forfeiture doctrine. In addition, the breach was likely material. Materiality is a question of interpretation, to be decided by assessing the importance of the breach in light of the purpose of the contract, determined by its terms and context. Had Barney intended to resell the property, Penny's failure to remove the slab may have been immaterial because it had no impact on the market value of the property. (Even under these circumstances, this outcome is not assured because the parties did stipulate for the slab's removal as part of the consideration for the barn.) However, Barney plans to live on the property, and it therefore cannot be said that the removal of the slab was merely incidental to the sale.

8. a. When, following a total breach, the plaintiff obtains a reasonable substitute performance, expectation damages are the difference between what the plaintiff had to pay for the substitute and what it would have had to pay under the contract for the equivalent performance. When the substitute not only is more expensive in itself but also involves the plaintiff in the extra expense of having to go outside the local market, the additional cost of transportation or (as in this case, travel and living expenses) is also included in determining the replacement cost. Therefore if Professor Wise is a reasonable

substitute for Bill, the law school will be able to recover substitutionary damages from Bill. These damages are not the full $19,000 paid to Wise, but rather the $9,000 difference between what it paid to Wise, $19,000, and what it would have paid Bill, $10,000.

Although it is seldom likely that a substitute performance will exactly match that promised under the contract, both the compensation and the mitigation principle require that the replacement be as close as possible. If the plaintiff is awarded the added cost of a more valuable or better-quality replacement, it is overcompensated, and its damages must be reduced to reflect the lower cost of a nearer substitute. However, this principle is not rigidly applied so that the plaintiff is invariably precluded from receiving reimbursement of the full cost of a superior replacement. As the victim of breach, the plaintiff has the burden foisted on it of finding a substitute to effectively counter the ill effects of the breach, sometimes within a very short time. When the only reasonable option open to the plaintiff under all the circumstances is to select a better replacement, it may be appropriate to hold the defendant accountable for the full cost, even if this means that the plaintiff profits somewhat by a performance superior to that expected. This is particularly so when the better substitute gives the plaintiff no realizable economic advantage.

In this case, Bill breached about two weeks before classes were to begin, and the dean had little time to find a substitute. She did make immediate efforts and only hired Professor Wise when it was apparent that she would be unlikely to find anyone else. She has no duty of exhaustive inquiry, but need only make such good faith and reasonable efforts called for by the circumstances. Even if Professor Wise is more experienced, has greater prestige, and may possibly be a better teacher, he may be the most reasonable substitute.

b. A court will not decree specific performance of personal services. Quite apart from the obvious difficulty in supervising the performance of teaching duties, the compulsion of personal services is rather too much like involuntary servitude. Therefore, even though the plaintiff may have no adequate remedy at law, the considerations disfavoring specific enforcement outweigh the plaintiff’s interest in performance.

If specific performance is not available, a court may be willing to grant the plaintiff a prohibitory injunction, restraining the defendant from entering into the transaction that motivated the breach. The concerns about involuntary servitude and difficulty of supervision are not present in such a negative order. Of course, preventing Bill from participating in the international transaction does not, in itself, achieve the school's expectation, but the idea is that by removing the motivation for the breach, the order will induce Bill to perform as promised. However, even when a prohibitory injunction is sought, courts are very wary about using their power of compulsion to prevent an individual from selling his labor and earning his livelihood as he sees fit. It is therefore in only the most compelling cases that a court will issue such an order.

Like specific performance, an injunction is an equitable remedy, subject to the same general prerequisites: The plaintiff must show that the legal remedy of damages is inadequate, and that the balance of equities favors the grant of the order. In this case, given the fact that no substitute is available, the possibility of substitutionary damages does not exist. This would lead to lost profits and consequential damages that (as Explanation 8(c) discusses) could be very speculative and difficult to prove. Furthermore, no monetary award can compensate for the immeasurable harm caused by the disruption of the law school's program, its inability to provide planned educational services, and the disappointment or even hostility of its students. Overall, a good argument can be made that the school has no adequate remedy at law. If this is so, the equities of trying to protect the law school's expectation weigh heavily in the balance. They are given further weight by the fact that Bill's breach is deliberate and motivated by ambition and financial reward. Nevertheless, Bill's primary professional pursuit is legal practice and the service of his clients' needs. It may simply be too harsh on Bill to restrain him. Also, there is a strong public interest in allowing people access to an attorney of their choice, so an injunction may improperly interfere with the attorney-client relationship. This would be particularly so if Bill has already agreed to represent the client. In short, without reaching a definitive conclusion, we can recognize that an injunction may be feasible, but there may not be enough here to overcome the court's disinclination to issue such an order.

c. Because the law school is unable, after reasonable effort, to replace Bill and avert the loss resulting from cancellation of the class, its net loss is claimable as direct damages. Of course, it cannot claim the full lost earnings of $75,000. First, it must establish that its forecast of tuition income is reasonably reliable and takes into account what likely proportion of enrolled students may exercise any available right to drop the course and be excused from paying tuition. Thereafter, it must deduct its savings from the breach and any recoupment of that loss. The most obvious saving is Bill's salary of $10,000. Although the facts do not indicate them, there may be some other variable (direct) costs that are saved. Overhead expenses such as maintaining the buildings and paying support staff are likely not reduced at all by the breach and are not deducted as costs saved. In addition, there may be some recoupment of the lost earnings if some of the students decide to switch to another summer school class instead, or if the law school's fee structure is such that the students end up paying more tuition in the semester for having to take the ethics course then. Once all these savings and recoupments are calculated, the law school is entitled to claim its lost profit—expected earnings less savings and recoupment—from Bill.

The payment to the student who sued for lost salary is a consequential loss. When a breach of contract causes the plaintiff to breach a dependent contract with a third person, the plaintiff's liability to the third person could be recoverable provided that the requirements of causation, reasonable certainty, foreseeability, and mitigation are satisfied. It is not clear that the law school was legally liable to the student for the loss of salary, because the school may have had the right to cancel the course, either by express stipulation or by common usage. If so, its payment could have been purely ex gratia, and under principles of causation and mitigation, the law school is not likely to be able to hold Bill accountable for this loss. However, the law school may have committed not to cancel the course, so that Bill's repudiation forced it into a breach of its contract with the student. Even if this is so, Bill would not be liable for this loss unless he reasonably could have foreseen it. Bill will be taken to have foreseen this damage either if the school told him of its commitment to students, or if, in normal practice, this kind of commitment was common enough that Bill should have been aware of it as a practitioner and former student. Assuming that the loss was reasonably foreseeable to Bill, the school must still satisfy the requirements of mitigation and reasonable certainty. It decided to pay the student's claim in full, rather than contesting it. However, failure to challenge the student's claim would not be an aggravation of loss if the student clearly established his claim, so that litigation over it would have been costly, pointless, and damaging to the school's reputation. Although reasonable certainty can be an issue in claims for lost future earnings, it seems that in this case the student did have a job and can establish his loss for the defined three-month period. (Maybe the student's employment was also contingent on his passing the bar, which would make his loss of earnings more speculative, but the facts do not indicate that this was an issue.)

9. a./b. These Examples raise the question of whether LaGoon must compensate Nat for shock, distress, and sentimental loss. The focus of contract damages is on economic loss, so the general rule is that no compensation is claimable for emotional distress or sentimental loss resulting from the breach. In some cases, losses of this nature could be excluded simply on the basis that they were not reasonably foreseeable. But even when there may have been some basis for contemplating them as a probable consequence of breach, the policy of confining contract damages to economic loss usually outweighs any sympathy for the plaintiff's suffering. There are, however, two situations in which courts have been willing to countenance a claim for emotional or sentimental damages:

The first occurs where the purpose of the contract is clearly and purely to enhance the plaintiff's emotional well-being. It may seem, at first thought, that the construction of a swimming pool in Nat's backyard, for his own personal use and enjoyment, is such a contract. However, courts constrict this exception more narrowly. As explained in section 18.13.1, the very basis and nature of the contract must be to provide sentimental or emotional benefit to the plaintiff. It is not enough, to remove the contract from the commercial realm, that the plaintiff's desire for the performance was motivated by personal pleasure rather than profit. The reason for this rather cold-hearted approach is probably quite obvious: If the exception were extended to cases like this, it could cover almost every consumer transaction in which it is clear that the primary motivation is the use of the property or services purchased to enhance quality or enjoyment of life.

The second situation in which a court may grant the plaintiff emotional distress damages is where the breach of contract is also a tort. This is not so much an exception to the rule barring emotional distress damages in contract as a recognition that some breaches of contract may involve conduct that is also a violation of duty under the law of torts. The noneconomic damages are therefore not really awarded for the breach of contract, but are independently compensable in tort. The damage to Nat's house was apparently caused by negligent operation of the earthmoving equipment. If this is so, the negligent performance is likely to constitute not only a breach of contract but also a tort, allowing Nat to go forward with his claim for mental distress damages. (Whether he satisfies the requirements of tort law for award of these damages is beyond our scope.)

c. The issue in this Example is whether Nat can claim punitive damages. The compensation principle also precludes punitive damages in most contract suits unless the breach is also a tort for which such damages are appropriate. Punitive damages are not generally available in tort law unless the injury was deliberate and malicious, or was at least the result of reckless and callous disregard for the plaintiff's rights. Therefore, even if LaGoon's employee did commit a tort by damaging Nat's house, this sounds more like a case of common negligence than the kind of conduct that warrants punitive relief.

10. If AC9's projections are credible, its expectation damages are its anticipated profit of $3 million plus the reliance expenses that it has already spent or committed for which it would have been reimbursed out of its earnings under the contract. (These expenses are discussed below.) It is not clear how convincing these projections may be. To recover lost profits, a plaintiff must be able to prove the fact and amount of those profits with reasonable certainty. AC9's projections may have been made by people with great expertise and experience and based on careful and thorough research. However, it is generally very difficult to establish prospective lost profits from a canceled entertainment event. Public taste can be unpredictable and often surprises even the most seasoned promoter. The prospect of profit is even less certain when the

show centers on something as odd as a performing chicken act. Given the substantial projected costs of mounting the show, AC9 would have to do remarkably well in selling both its tickets and its associated knick-knacks. Its prediction that it could sell out a stadium of 100,000 seats shows laudable, but possibly misplaced, faith in the artistic sensibilities of the American public. Had ticket sales begun before Chic repudiated, AC9 would have had some data on which to project its prospects of filling the stadium, but she reneged before any promotion of the show had begun.

If AC9 cannot prove lost profits, what other alternatives does it have? Restitutionary relief would be available to reclaim Chic's unjust enrichment, but that would cover only the $100,000 down payment. None of the other expenditure enriched her in any way. However, a plaintiff who cannot prove lost profit may nevertheless still recover as reliance damages the expense component of its expectation claim. A claim of reliance damages would permit the recovery of not only the $100,000 down payment, which qualifies as essential reliance, but also some of the other losses incurred in reliance on the contract. Provided that they were reasonably necessary to AC9's performance under the contract and were not profligate, the forfeited stadium deposit and the staff salaries are recoverable in reliance. (They are probably best classified as essential reliance, in that they were expended in furtherance of AC9's contractual obligation to arrange and promote the show.)

The debt for television advertising would also fall into this category, but only to the extent that the expenditure is wasted and not salvageable. Although the advertising slots cannot be canceled, they may be assignable or diverted to use for other purposes. Therefore, to the extent that AC9 can recoup its expenditure by selling the slots or using them for another show, it is not claimable as a reliance loss.

The cost of the market survey and profit projection were incurred before the contract was entered into, so even though these expenses were a waste in the end, they cannot, by definition, be treated as having been incurred in reliance on the contract. This seems to be the general approach to precontractual expenses, notwithstanding that the breach cut off any prospect of earning income that may have reimbursed them.[23]

As noted above, AC9 would claim reliance only if it could not prove its larger claim of lost profit. The plaintiff does not have to prove that the contract would have made a profit to recover reliance damages. However, when the purpose of the contract was profit, and the defendant is able to prove that the plaintiff would have made a loss in the event of complete performance, the court will reduce the reliance recovery to take account of this expectation of loss. (As explained in section 18.8.2, it is fairer and more in accord with compensation principles to make a pro rata reduction in the recovery, rather than to deduct the entire anticipated loss.) In a case like this one, where profit is highly speculative, the risk of uncertainty therefore falls on the defendant. Chic probably has about as much chance of proving loss as AC9 has of proving profit, so she probably cannot satisfy her burden, and AC9's recovery is not likely to be subject to reduction.

Chicago Coliseum Club v. Dempsey, 265 Ill. App. 542 (1932), is an old case but a good illustration of an award of reliance damages to a plaintiff who could not prove the profitability of an entertainment event. Jack Dempsey, the world-champion heavyweight boxer, repudiated a contract with the club to participate in a boxing match. The club was not able to prove its lost profit, but the court recognized its right to claim reliance damages for its post-contractual expenses reasonably and necessarily incurred in the course of organizing the match. (The club had also incurred expenses prior to the execution of the contract, but the court did not allow the recovery of these expenses, which predated and therefore could not have been incurred in reliance on the contract.) *Wartzman v. Hightower Productions, Ltd.*, 456 A.2d 82 (Md. 1983), involved an entertainment event almost as culturally significant as Chic's. A group of bright entrepreneurs embarked on an elaborate venture designed to make money out of breaking the world flagpole-sitting record. They planned to lodge an entertainer in a specially constructed perch atop a hydraulic lift mounted on a flatbed trailer, and to exhibit him around the country for about nine months, culminating in his descent from the perch in Times Square on New Year's Eve. They needed capital for this, so they contracted with an attorney to form a corporation that could solicit investments. The attorney was incompetent and failed to create an entity in compliance with securities law. This was discovered only after the promoters had incurred expenses in setting up the project. They could not proceed further without engaging in a complex and expensive procedure to remedy the violation of the securities law. The promoters could not afford the expense or the delay of the cure and the venture collapsed. The corporation was unable to prove that it would have made a profit from the venture, but the court awarded it reliance damages to compensate for the wasted expenditures incurred in reliance on the attorney's contractual commitment to incorporate the enterprise properly.

11. Had Reliant's cost been as it had estimated, it would have had a reasonable expectation of profit. Benny Fishery's material breach would have entitled it to full expectation damages, calculated by adding its reliance expenditure, which would have been $50,000, to its anticipated profit of $30,000. However, Reliant's miscalculation of its cost has defeated its expectation of profit and its claim for expectation damages. Its only reasonable expectation from full performance is a loss of $20,000. As a result, its claim is confined to reliance or restitutionary damages.

    Its reliance damages are its cost of $100,000, but they may be even less than this if the defendant can make a case for reducing them. If the defendant can prove that the plaintiff's reasonable expectation under the contract was to lose money, the plaintiff's reliance recovery may be reduced to adjust it for that expectation of loss. The burden of proving the losing expectation is placed on the breaching defendant, and the plaintiff's reliance recovery is unaffected if the defendant cannot sustain the burden. Even if Benny can show that Reliant would have lost money had it performed the contract, Reliant would be unfairly undercompensated if the full amount of the expected loss was deducted from a reliance recovery that constitutes only a portion of its performance. The deduction should therefore be prorated so that it is no more than a share of the loss proportionate to the performance rendered. The most rational way of allocating the loss to completed performance is to determine its proportion of the total contractual performance based on the relationship of the cost incurred to the total cost of performance. In the present case, Reliant had incurred costs of $100,000 out of a total anticipated cost of $250,000—that is, two-fifths of the total. Therefore (provided that Benny Fishery can prove this anticipated loss), the $100,000 reliance expenses must be reduced by two-fifths of the total expected loss of $20,000, which is $8,000, leaving a recovery of $92,000.

Reliant's alternative to seeking reliance damages is to claim restitution. Restitution is measured by the market value of the work performed (quantum meruit). Unless Reliant performed inefficiently, incurring costs in excess of what would be normal on the market, the value of its performance is likely to be higher than its cost, because it would include a reasonable profit. For the sake of illustration, if the costs are indeed efficient and the industry norm is to have a 10 percent profit margin on excavation work, the market value of the performance is $110,000. Because restitution would provide a larger recovery, it would make sense for reliance to choose this basis for relief. However, some courts, uncomfortable with the anomaly of achieving different results in reliance and restitution for exactly the same breach, have applied a version of the prorating principle to restitution by confining the plaintiff to the contract value of the performance where that is less than the quantum meruit measure. In the present case, as two-fifths in value of the work was done, a court following this rule would confine Reliant to two-fifths of the contract price of $230,000. This works out to a recovery of $92,000—the same as the prorated recovery for reliance. Other courts have not extended the prorating principle to restitution because the plaintiff claiming restitution is proceeding on the basis of unjust enrichment, not contract, and those courts do not see it as appropriate to reduce the plaintiff's recovery by the price of the performance set by the breached and disaffirmed contract.

12. Sauce Source is attempting to enforce an agreed damages provision.[24] The agreement is on a standard form, but that in itself is not relevant unless Gracie can show that the term was unconscionable. To use unconscionability as the basis for attacking a liquidated damages clause, Gracie would have to show not only that the provision was substantively unconscionable but also that it was adhesive or otherwise procedurally unconscionable. Although unconscionability may be an alternative basis of overturning a liquidated damages provision, we do not explore that issue here. The important point to note is that it is not necessary to show unconscionability or other bargaining unfairness to challenge a liquidated damages provision. The basis of the challenge is simply that the provision imposes a penalty for breach, which is unenforceable as a violation of the compensation principle. The compensation principle requires study of an agreed damages provision to ensure that it is a

genuine attempt to liquidate damages and not an unenforceable penalty. Because this is a sale of goods, the validity of the provision is tested under UCC §2.718(1), which employs a two-point test, later adopted for the common law by Restatement, Second, §356. The agreed damages are examined in light of both the anticipated harm at the time of contracting, and the actual loss following breach. (Both §§2.718 and 356 uphold the liquidated damages provision if the liquidated damages are reasonable in light of either "anticipated or actual" loss.) The test of anticipated loss requires that the liquidation of damages must be a genuine attempt to reasonably estimate loss at the time of contracting. The more difficult the prospect of proving loss appeared at that time, the greater leeway the parties should be given in coming up with a figure. However, if the basis of determining loss would have been reasonably straightforward at the time of contracting, the parties are held to a higher standard in calculating a figure that approximates expected loss. When actual loss is apparent following breach, the measurement against actual loss allows the court to uphold the award if it has a reasonable relationship to actual loss, even if it was not originally a reasonable estimate of loss.

We are given no facts about how the agreed damages were calculated. However, if we examine the effect of the provision, it becomes clear that the clause cannot be justified as being a realistic prognostication of harm. In most sales of goods, the seller's damages are relatively easy to predict and calculate. If the goods are resold after breach, the difference between the contract and resale price is quite easily ascertainable. If they are not resold or the resale is unreasonable, the contract-market difference can be established. If there is no substitute sale (for example, because the seller loses volume of sales, as alleged by Sauce Source in this case), the seller's lost profit can be proved without too much difficulty. Finally, if the goods are perishable and cannot be resold, the seller is able to sue the buyer for their price. Although there could be uncertainties and disagreement on a number of issues, such as the reasonableness of resale, the market price, or the issue of lost volume, these difficulties are not comparable to, say, the problems of proving lost profits for a speculative venture. There is enough predictability to require the plaintiff to show a sensible basis for coming up with an estimate that bears some relationship to reality.

Instead, Sauce Source has used a formula that assures it of full recovery of the sale price, no matter how much it actually delivers to Gracie. If there ever was a term designed as a disincentive to breach— that is, a penalty—this is it.

Furthermore, like the liquidated damages provision in *Lake River Corp. v. Carborundum Co.* (discussed in section 18.11), the amount of damages is quite random in its relationship to loss and ensures that Sauce Source is always overcompensated. To demonstrate, consider the following calculations based on arbitrarily selected, but generous, actual damage figures: Gracie breached after taking her minimum requirements for seven months, so she is liable for agreed damages of 5 × \$250 = \$1,250, representing her failure to take 50 boxes of sachets.

If the ketchup can be readily resold at full price, the damages may overcompensate Sauce Source by a full \$1,250 (less any incidental damages). But even if it resells at a huge loss, say at \$5 a box, its actual damages would still be considerably less than what was agreed: They would be \$1,000, the difference between the contract price of the 50 boxes (\$1,250) and their resale price of \$250.

Even if we assume that it makes no substitute transaction because it has more ketchup than it can sell, so it loses volume of sales, the agreed damages must still exceed its lost profit, no matter how big its profit margin may be. To illustrate, let's say that its total cost of buying the sachets at wholesale and selling them is only \$2 per box, so that makes a generous profit of \$23 per box. Its lost profit is still only 50 × 23 = \$1,150—\$100 below the agreed damages.

In fact, there seem to be only two situations in which it could have anticipated a loss equal to the damages provided. Both are highly unlikely. First, if its costs are zero and it has suffered loss of volume, its lost profit would be equal to the agreed damages. Second, if it could not resell at all and the ketchup would spoil and have to be discarded, it would lose the entire contract price. Although this could occur where perishables are sold, ketchup in sealed packages probably has a distant expiry date, which would give Sauce Source much more opportunity to sell it before it spoils.

This set of calculations is based on Gracie's breach in the seventh month of the contract. If you care to do some further arithmetic, you will see that the earlier the breach, the greater the discrepancy between the damages fixed and the reasonably likely harm. However, at no point, not even in the last month, does this disproportion entirely disappear. Our inquiry to establish that the agreement on damages was not a reasonable forecast of harm also shows that the comparison between the liquidated damages and actual damages would lead to the conclusion that the amount of liquidated damages will invariably be higher than any actual damages suffered by Sauce Source.

If agreed damages are invalid what are Sauce Source's actual damages? When an agreed damages provision is invalidated, the plaintiff does not lose all remedy. It may still recover whatever actual damages it suffered. If Gracie is correct in saying that the market value of ketchup rose since the contract was entered into, Sauce Source would not be able to claim damages based on the difference between the higher market price and the contract price. Similarly, if it entered a substitute transaction by reselling in a commercially reasonable way, it probably sold at the higher price and cannot claim damages based on resale. It does make the argument, however, that even if it did make a subsequent sale, this was not a substitute because it has enough ketchup in stock to satisfy all demand. As discussed in section 18.6.3d, if Sauce Source can show that the breach caused a reduction in its volume of sales and that it had unused capacity to supply all of the demand for ketchup, it should be able to claim its lost profit under §2.708(2). Despite the language in §2.708(2) that "due credit" must be given for "proceeds of resale," most courts accept that this does not apply in a lost volume situation.

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1. Remedies for nonmaterial breach are discussed in Chapter 17. Of course, some of the principles discussed here, such as mitigation of damages and reasonable certainty of damages, are applicable to nonmaterial breach as well.

2. *See* section 18.10.

3. There are limited exceptions to this rule—discussed in section 18.13—when the defendant's conduct in breaching is also tortious or the contract is especially aimed at giving the plaintiff a noneconomic benefit.

4. The total transaction costs incurred as a result of the breach include those costs incurred by the breaching party in entering into the more attractive transaction and the costs incurred by the victim of the breach in dealing with the breach and making any substitute transaction.

5. The claim in the example is for $300. Although it is used here for the purposes of illustrating the process of collection, it should be noted that when the amount in issue is that small (or indeed, even considerably larger), very few plaintiffs would incur the legal expense of pursuing it. It would not take long for legal costs to exceed it.

6. The term "direct damages" is explained in section 18.5. In essence, they are the damages awarded to compensate the plaintiff for the loss of expectation under the contract itself, rather than as a result of the impact of the breach on other rights of the injured party or other transactions that are affected by the breach.

7. Although §2.708(2) refers only to contract-market damages, lost profits should also be claimable under that section when the resale remedy under §2.706 is inadequate.
8. Consequential damages are explained in section 18.5.
9. This shows that in some circumstances lost profits are direct damages, but in other circumstances they are consequential damages. They are direct damages when they compensate for the profit that the party would have made under the contract itself (see sections 18.3.c and d). However, in this example they are consequential damages—profits lost in another transaction as a consequence of the breach.
10. *Hadley* has a famous headnote that clearly states that the clerk was told that the mill was stopped. However, the opinion itself indicates otherwise. Commentators have suggested that the headnote (written by the reporter, not the court) does not accurately reflect the facts or that even if there was communication to the clerk, this was not sufficient to bind his employer.
11. *See also* section 17.7.4, in which the issue of mitigation is discussed in relation to the decision by the victim of a repudiation on whether to accept and act on the repudiation immediately or to await the possibility of retraction.
12. These terms are expanded on below with qualifications that are not raised at this stage.
13. Although expenses incurred in anticipation of a contract are not recoverable as reliance damages for breach of contract, they may sometimes be recoverable under the separate theory of promissory estoppel. However, as we see in section 8.9, it is difficult to establish justifiable reliance on precontractual promises in most situations.
14. This section discusses only restitution in favor of the victim of the breach. It does not consider restitution in favor of a breaching party, which is discussed in section 17.6.2. That section explains that, as a general rule, when a contract is rescinded for breach, the breaching party is also entitled to the restitution of any benefits that she conferred on the other party prior to her breach. However, the breaching party's restitution is subject to limitations and is offset by any damages due to the victim.
15. *See* section 2.5 for a fuller explanation of the distinction between law and equity.
16. *See* section 18.2.4 for an explanation of the enforcement of a damages award.
17. Restatement, Second, §353 describes this exception as applicable to a *contract or breach* of a kind that makes serious emotional disturbance particularly likely. Although the text of the section appears to contemplate either a contract or a breach that is likely to cause emotional distress, the comments and caselaw indicate that the nature of the contract is the key factor.
18. The degree of overcompensation is reduced by the fact that a portion of the award will be used to pay attorney's fees and the costs of preparing for and conducting the litigation.
19. Contracts of adhesion are discussed in section 13.12.
20. This was a repudiation because it occurred in advance of Cliff's duty of performance. You may wonder if Cliff could have raised the defenses of mistake or impracticability. However, assume that neither defense would have worked to excuse his termination of the contract.
21. This issue is discussed in section 10.5.
22. Of course, had Harpo breached, Trés Trendi would not have been able to obtain an order of specific performance to compel his personal services because of the strong policy against forcing an individual to work against his will. However, this policy is not implicated where the employee sues the employer for specific performance, and orders of reinstatement are common.
23. There have been some situations in which courts have been willing to include precontractual expenses in reliance recovery. For example, if the defendant knew that the plaintiff was incurring the expenses in anticipation of the contract and had strongly indicated an intention to enter the contract, promissory estoppel relief may be available for the precontractual expenses. Also, the expenses could qualify as lost opportunity reliance if the plaintiff could have recouped them by entering a similar contract with a third party but gave up that chance by entering the contract with the defendant.
24. When a party promises to take a specified quantity of goods or to pay for that quantity even if it is not taken, the term is sometimes interpreted not as an attempt to liquidate damages but as a "take or pay" provision, which is not subject to regulation as agreed damages. "Take or pay" clauses are

typically found in long-term supply contracts where the supplier incurs the bulk of its costs at the outset. The buyer's commitment to pay for a minimum quantity is justified because it is needed to enable the supplier to recoup that cost. Such facts are not present in our case. The clause is both described in the contract as, and functions as, a liquidation of damages.