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Expectancy Damages for Breach of Contract: A Primer and Critique

David H. Vernon

University of Iowa College of Law

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EXPECTANCY DAMAGES FOR BREACH OF CONTRACT: A PRIMER AND CRITIQUE

DAVID H. VERNON*

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* Law School Foundation Professor of Law, University of Iowa. A.B., 1949, LL.B., 1952, Harvard University; LL.M., 1953, J.S.D., 1960, New York University Law School. The author would like to acknowledge the research assistance of Gary Kazragis

I. INTRODUCTION

When a contract is breached, the traditional remedy available to the aggrieved party is an award of money damages. Courts attempt to place the aggrieved party in the financial position that party would have occupied had the contract been performed—by awarding expectancy damages.¹ Such damages are those the parties reasonably should have foreseen on the basis of facts known to them at the time of the contract.² The aggrieved party must take reasonable action to minimize the amount awarded³ and is prohibited from taking action that increases that amount.⁴ As part of their agreement, the parties may stipulate the amount payable on breach. If their estimate is reasonable and the actual damages are difficult to ascertain, courts will enforce such provisions.⁵

While the traditional rules have been modified by statute⁶—particu-

and Gus Kerndt during the 1975-76 academic year and of Lisbeth Keller and Bruce Stoltze during the summer of 1976. All were or are students at the University of Iowa College of Law. All persons doing work in contract damages owe a debt of gratitude to Professor E. Allan Farnsworth for his outstanding article, *Legal Remedies for Breach of Contract*, 70 COLUM. L. REV. 1145 (1970). While the article was not cited for specific points, it had an impact on the author's thinking and that impact is hereby acknowledged.

1. See RESTATEMENT OF CONTRACTS § 329 (1932); notes 17-19 *infra* and accompanying text.

2. See RESTATEMENT OF CONTRACTS § 330 (1932); notes 92-105 *infra* and accompanying text.

3. See RESTATEMENT OF CONTRACTS § 336 (1932); notes 131-45 *infra* and accompanying text.

4. See RESTATEMENT OF CONTRACTS § 336 (1932); notes 116-30 *infra* and accompanying text.

5. See RESTATEMENT OF CONTRACTS § 339 (1932); notes 162-80 *infra* and accompanying text.

6. For statutes regulating the employee-employer relationship, see ALASKA STAT. § 23.10.030 (1962) (employee induced to accept employment by false representations may recover reasonable attorneys' fees and "actual" damages); DEL. CODE ANN. tit. 19, § 1103(d) (1974) (10% penalty if wages are withheld by the employer "without any reasonable ground for dispute"); ME. REV. STAT. ANN. tit. 26, §§ 625-A, 626 (Cum. Supp. 1975) (establishing severance pay requirements and permitting the award of attorneys' fees in suits for severance pay); MINN. STAT. § 181.68 (1974) (permitting recovery of twice the amount of underpayment resulting from sex discrimination); N.Y. LABOR LAW § 681(1) (McKinney Supp. 1975) (permitting farm laborers paid below the minimum wage to recover the underpayment, attorneys' fees and a 25% penalty for a wilful failure to pay); ORE. REV. STAT. § 652.150 (1973) (penalty of up to 30 days' wages for failure to pay wages due an employee who is discharged or quits).

For statutes regulating a variety of specialized commercial contracts, see ARIZ. REV. STAT. ANN. § 10-716(D) (1956) (validating liquidated-damage provisions in bylaws of cooperative marketing associations in contracts with members); FLA. STAT. ANN. §

larly by the Uniform Commercial Code⁷—expectancy damages still

352.32 (1973) (double damages against captains of steamboats who fail to place freight in a dry, convenient place); HAWAII REV. STAT. §§ 422-23 (1968) (liquidated-damage clauses in contracts of fish marketing associations); IND. ANN. STAT. § 15-7-116.1(a) (Burns 1973) (liquidated-damage clauses in agricultural cooperative marketing contracts); KAN. STAT. ANN. § 55-202 (1964) (award of \$100, attorneys' fees, and other proven damages for failure to execute release of forfeited lease); MASS. ANN. LAWS ch. 93E, § 7 (1975) (damages for breach of statutory requirements governing the relationship between retailers and wholesalers of petroleum products); NEB. REV. STAT. § 54-1808 (1974) (double damages for failure to pay for slaughtered cattle by the end of the business day following purchase); R.I. GEN. LAWS ANN. § 4-7-22 (Cum. Supp. 1975) (treble damages and attorneys' fees for failure to pay a licensed cattle dealer for cattle purchased); S.C. CODE ANN. § 46-150.161 (Cum. Supp. 1975) (double recovery against persons engaged in selling motor vehicles who fail to meet statutory obligations to buyers).

For consumer protection laws, see ARK. STAT. ANN. § 70-922 (Cum. Supp. 1975) (permitting consumer to recover 10% of the transaction total or \$100, whichever is greater, plus normal expectancy damages); COLO. REV. STAT. ANN. § 6-1-113 (1973) (authorizing award of attorneys' fees for violations of the Colorado Consumer Protection Act); IDAHO CODE §§ 28-35-201 to 205 (Cum. Supp. 1976) (debtor's remedies under the Idaho Uniform Consumer Credit Code); MICH. COMP. LAWS ANN. § 125.996 (Cum. Supp. 1975) (treble damages for wilful failure of a manufacturer or dealer to correct a defect covered by a warranty in the sale of a mobile home); MO. ANN. STAT. § 407.410 (Vernon Supp. 1976) (double damages for contract involving a "pyramid sales scheme"); PA. STAT. ANN. tit. 41, § 502 (Cum. Supp. 1975) (treble damages when charges for loans exceed statutory limits); TEX. REV. CIV. STAT. ANN. art. 5069-13.03(7) (c) (Cum. Supp. 1976) (recovery of attorneys' fees in suits by consumers when merchants are found to have violated statute); WIS. STAT. ANN. §§ 422.411 to 413 (1974) (damage awards against consumers in certain transactions).

For statutes regulating landlord-tenant relationships, see ILL. REV. STAT. ch. 24, § 11-31.1-12.1 (1973) (treble damages against landlord who collects rent when occupancy rate exceeds statutory limit); IOWA CODE § 562.14 (1975) (punitive damages up to \$200 against landlord who, acting in bad faith, retains tenant's deposit); MD. REAL PROP. CODE ANN. § 8-204(e) (1974) (landlord liable for consequential damages for failure to provide tenant with possession at the time called for in the lease); N.J. STAT. ANN. § 46:8-21.1 (Cum. Supp. 1975) (double recovery and attorneys' fees for wrongful failure of landlord to return tenant's deposit); TENN. CODE ANN. § 64-2842 (Cum. Supp. 1975) (damage remedies against landlord who fails to provide essential services).

For general rules of contract damages, see, e.g., GA. CODE ANN. §§ 20-1402 *et seq.* (1975) (dealing with the nature of contract damages, liquidated damages, penalties, expenses of litigation, exemplary damages, remote and consequential damages, foreseeability requirements, interest, nominal damages, mitigation, discretion of juries, necessary expenses, and special provisions relating to breach of covenants relating to land).

For statutes regulating contracts with public agencies, see MISS. CODE ANN. § 29-1-47 (1972) (portion of purchase price paid by buyer of forfeited tax lands as liquidated damages); WASH. REV. CODE ANN. § 54.04.080 (Supp. 1975) (deposit as proper measure of liquidated damages in bids submitted to public utility districts).

For special contract damage provisions, see CAL. CIV. CODE §§ 1670-71 (Deering 1970) (liquidated damages); CONN. GEN. STAT. REV. § 52-236 (1975) (aggrieved party in contract action may introduce evidence of damages accrued after filing of suit).

7. UNIFORM COMMERCIAL CODE, art. 2, pt. 7.

constitute the usual response to damage suits "on the contract."⁸ In appropriate cases, the injured party has the option of waiving a contract recovery and suing for restitution of the value of the partial performance rendered, an amount not limited by the contract price.⁹ Aggrieved parties also may obtain money recoveries on a promissory estoppel theory,¹⁰ through the partial-enforcement concept of the tentative *Restatement (Second) of Contracts*¹¹ or the full-enforcement rule of the original *Restatement*.¹² The party who breaches the contract also has restitutionary rights.¹³ The breaching party generally is able to recover the value of the performance rendered before breach, subject to the aggrieved party's right to expectancy damages, up to a maximum share of the contract price proportionate to the work completed.¹⁴ Finally, reliance damages are available when an expectancy recovery is too remote and speculative to be ascertained.¹⁵

This Article is devoted primarily to describing and analyzing the conceptual framework within which courts traditionally have awarded expectancy damages—the "primer" and "critique" of the title. Expectancy rules lie at the center of traditional theory and are widely accepted. In many instances, however, they create problems in application and thus frequently are ignored by the courts. The existence of several different and contradictory bases for recovery in any given suit creates further problems. Despite the apparent widespread acceptance of the expectancy rules, therefore, Professor Gilmore has suggested that expectancy damages are dead or at least dying.¹⁶ Before we can determine the state of its health, however, the system itself must be understood. This Article, which analyzes the traditional system of expectancy damages, is a preface to further work examining the present state and future prospects of expectancy damages.

8. As distinguished from suits seeking the restitution of value given, when a claim is "on the contract," the calculation of damages normally starts with the contract price.

9. See RESTATEMENT OF CONTRACTS § 346 (1932); notes 208-19 *infra* and accompanying text.

10. See RESTATEMENT OF CONTRACTS § 90 (1932).

11. RESTATEMENT (SECOND) OF CONTRACTS § 90 (Tent. Draft 1973).

12. See note 10 *supra*.

13. See RESTATEMENT OF CONTRACTS § 357 (1932); notes 220-26 *infra* and accompanying text.

14. See note 13 *supra*.

15. See RESTATEMENT OF CONTRACTS § 333 (1932); notes 198-207 *infra* and accompanying text.

16. G. GILMORE, THE DEATH OF CONTRACT 51-53, 83-84, 88 (1974) [hereinafter cited as GILMORE].

II. EXPECTANCY DAMAGES— THE TRADITION AND THE THEORY

A. *The General Rule*

1. *Total Breach*

Whatever complicating factors may arise in calculating expectancy damages, the goal remains constant: to ascertain the dollar amount necessary to ensure that the aggrieved party's position after the award will be the same—to the extent money can achieve the identity—as if the other party had performed.¹⁷ The courts assume that the reasonable expectations of the parties define the position they would have achieved had the contract been performed; these expectations are treated as substitutes for actual performance. Subject to limitations on

17. See *Alover Distrib., Inc. v. Kroger Co.*, 513 F.2d 1137, 1140 (7th Cir. 1975) (long-term contract for sale of ice cream); *Pelz v. Christian Herald Ass'n*, 486 F.2d 94, 97 (5th Cir. 1973) (travel agency's breach of exclusive agency relationship with tour operator); *Interstate United Corp. v. White*, 388 F.2d 5, 7 (10th Cir. 1968) (contract for sale of a vending machine business); *Ellis Canning Co. v. Bernstein*, 348 F. Supp. 1212, 1234 (D. Colo. 1972) (contract for sale of corporation); *Mid-Continent Tel. Corp. v. Home Tel. Co.*, 319 F. Supp. 1176, 1198 (N.D. Miss. 1970) (corporate merger agreement); *Hover v. Kirk*, 56 Ala. App. 257, 259, 321 So. 2d 214, 216 (1975) (sale of home); *McBain v. Pratt*, 514 P.2d 823, 828 (Alas. 1973) (husband agreed to leave his law practice or its value to his children); *Rebsamen Cos. v. State Hosp. Employees Fed. Credit Union*, 258 Ark. 160, 162-63, 522 S.W.2d 845, 847 (1975) (default on secured note); *Fisher v. Hampton*, 44 Cal. App. 3d 741, 752, 118 Cal. Rptr. 811, 817 (1975) (drilling an oil-gas well); *Taylor v. State Bank*, 165 Colo. 576, 580, 440 P.2d 772, 774 (1968) (special bank-account agreement); *Bell v. McCann*, 36 Colo. App. —, —, 535 P.2d 233, 235 (1975) (construction of house); *Gordon v. Indusco Mgmt. Corp.*, 164 Conn. 262, 272, 320 A.2d 811, 818 (1973) (construction contract); *Ashland Oil, Inc. v. Pickard*, 269 So. 2d 714, 723 (Fla. Ct. App. 1972) (sale of fiberglass hulls); *Crawford & Assoc., Inc. v. Groves-Keen, Inc.*, 127 Ga. App. 646, 650, 194 S.E.2d 499, 502 (1972) (sale of customer lists); *Goodwin, Inc. v. Coe Pontiac, Inc.*, 62 Mich. App. 405, 409, 233 N.W.2d 598, 602 (1975) (sale of automobile dealership); *McDaniel Bros. Constr. Co. v. Jordy*, 195 So. 2d 922, 925 (Miss. 1967) (brokering construction contract); *Boten v. Brecklein*, 452 S.W.2d 86, 93 (Mo. 1970) (management contract); *Peter Salvucci & Sons, Inc. v. State*, 110 N.H. 136, 154, 268 A.2d 899, 911 (1970), *aff'd*, 111 N.H. 259, 281 A.2d 164 (1971) (highway construction); *Allen v. Allen Title Co.*, 77 N.M. 796, 798, 427 P.2d 673, 675 (1967) (escrow agreements); *Fulcher v. Nelson*, 273 N.C. 221, 226, 159 S.E.2d 519, 523 (1968) (sale of car); *Kotan v. School Dist. No. 110C*, 13 Ore. App. 139, 151, 509 P.2d 452, 458 (1973) (employment contract); *United Bank v. Dick Herriman Ford, Inc.*, 215 Va. 373, 376, 210 S.E.2d 158, 161 (1974) (failure to record lien on title certificate); *Prier v. Refrigeration Eng'r Co.*, 74 Wash. 2d 25, 30, 442 P.2d 621, 624 (1968) (installation of ice rink surface); *Denhart v. Waukesha Brewing Co.*, 21 Wis. 2d 583, 595-96, 124 N.W.2d 664, 670-71 (1963) (employment contract).

awarding consequential (or special)¹⁸ damages, therefore, the expectancy award is calculable by subtracting the injured party's actual dollar position as a result of the breach from that party's projected dollar position had performance occurred.¹⁹

Problem 1. The Buyer Recovers. Alice, a subdivider, and Bob, a school teacher, entered into a written contract under which Alice was to sell and Bob to buy a specific lot of land for \$2,700. The market price for the lot was \$3,000. When Bob tendered \$2,700 to Alice and requested that the lot be conveyed, Alice refused, saying that she had sold it to Clara. Bob filed suit against Alice requesting money damages.²⁰

If Alice's action were a breach of contract, Bob would recover \$300.²¹ The object of expectancy damages is to place Bob in the position he would have occupied had the contract not been breached. Had the contract been performed, Bob would have paid Alice \$2,700 and he would have received land worth \$3,000—a net gain to Bob of \$300. Since he retained the \$2,700, a \$300 award would leave him with the net gain he would have had but for the breach. The \$300 award would also leave Alice in the dollar position she would have occupied had she performed—losing \$300 as the result of exchanging a \$3,000 lot for \$2,700 in cash. In Problem 1, therefore, expectancy damages would leave *both* parties in the position in dollar terms they would have achieved with performance.

18. See *Hadley v. Baxendale*, 156 Eng. Rep. 145, 151 (Ex. 1854); notes 93-115 *infra* and accompanying text.

19. See note 17 *supra*.

20. See *Boyd v. Mercantile Safe Deposit & Trust Co.*, 28 Md. App. 18, 22, 344 A.2d 148, 152 (1975) (money damages for breach of real estate contract). Alice no longer owns the land, having conveyed it to Clara. Unless Clara takes the land with notice of Bob's interest, specific performance will not be available to him as a remedy. See *Grummel v. Hollenstein*, 90 Ariz. 356, 359, 367 P.2d 960, 962 (1962). If Alice merely contracts to convey to Clara, Bob might succeed in an action for specific performance. See *Bolton v. Barber*, 233 Ga. 646, 648-49, 212 S.E.2d 766, 769 (1975). In any event, Bob is free to file a damage action.

21. See *Mitchell v. Fritz Silberman Realty Corp.*, 27 Ill. App. 3d 262, 264, 327 N.E. 2d 183, 184 (1975); *Dunning v. Alfred H. Mayer Co.*, 483 S.W.2d 423, 428 (Mo. Ct. App. 1972) (American rule on damages: "When a contract relating to the purchase of real estate has been breached, the rule in this and most states is that the vendee is entitled to damages in a sum equal to the difference between the unpaid part of the agreed purchase price and the market price of the land"); *Kellog v. DePasquale*, 42 App. Div. 2d 667, 345 N.Y.S.2d 702, 703 (1973). *But see* *Charles County Broadcasting Co. v. Meares*, 270 Md. 321, 326, 311 A.2d 27, 31 (1973) (English rule: damages limited to return of earnest money unless vendor acted in bad faith, in which case full value of land is awarded); *Flureau v. Thornhill*, 96 Eng. Rep. 635 (K.B. 1776). *See also* *Ocean Air Tradeways, Inc. v. Arkay Realty Corp.*, 480 F.2d 1112 (9th Cir. 1973) (California follows English rule in bankruptcy cases).

A general formula is applicable to cases in which a seller, having made an unfavorable contract, fails to perform. An award calculated by subtracting the contract price from the market price at the time and place of breach²² will give expectancy to the buyer. Expenses saved by the buyer as a result of the breach must be subtracted,²³ and incidental damages added,²⁴ however, to leave the buyer in the same position as if the contract were performed. If incidental damages are added, Alice is left in a worse position than if she performs unless the expenses saved by nonperformance are at least as large as the incidental damages awarded to Bob.

If the transaction in Problem 1 involved the sale of a used car rather than land, the Uniform Commercial Code rather than the analysis presented above would govern in every jurisdiction but Louisiana.²⁵ The analysis and result, however, are identical. Code section 2-713(1) imposes a market price-contract price formula to achieve the expectancy goal codified in section 1-106(1) of the Code.²⁶

The expectancy damage system concentrates on achieving expectancy for the aggrieved party. As in Problem 1, however, where there are no consequential or incidental damages, the system leaves the breaching seller with her expectancy loss. If the expectancy system forms the basis of an out-of-court settlement, Alice neither gains nor loses. Whether or not she performs the unfavorable contract, she occupies the same position. If a compromise settlement is reached, she might achieve a better position than had she performed.²⁷ To this

22. See *Tansil v. Horlock*, 204 So. 2d 457, 461-62 (Miss. 1967); *Wilt v. Waterfield*, 273 S.W.2d 290, 296 (Mo. 1954); *Missouri Slope Livestock Auction, Inc. v. Wachter*, 107 N.W.2d 349, 352-53 (N.D. 1961) (applying statute); *Freedman v. Cholick*, 233 Ore. 569, 572, 379 P.2d 575, 577 (1963); *Roselawn Cemetery, Inc. v. Martin*, 415 S.W.2d 442, 445 (Tex. Civ. App. 1967 no writ) (cemetery plots).

23. RESTATEMENT OF CONTRACTS § 335 (1932).

24. *E.g.*, *Tansil v. Horlock*, 204 So. 2d 457, 462 (Miss. 1967) (seller liable for cost incurred by buyer in moving and storing furniture). See also *Missouri Slope Livestock Auction, Inc. v. Wachter*, 107 N.W.2d 349, 352-53 (N.D. 1961) (applying statute).

25. See R. SPEIDEL, R. SUMMERS & J. WHITE, *TEACHING MATERIALS ON COMMERCIAL AND CONSUMER LAW* 19 (2d ed. 1974).

26. UNIFORM COMMERCIAL CODE § 2-713(1).

27. If the case is tried, charges by lawyers and court costs decrease the net recovery of the aggrieved party and increase the cost of the breach to the party who breaches. Both sides are under some economic pressures to compromise. Any settlement for an amount below the market-price-contract-price differential will leave the breaching seller in a better position than if he performed; and a settlement in which the aggrieved party receives the market-price-contract-price differential, minus any amount less than the cost

extent the system encourages her to breach. In economic terms Alice is indifferent between performance and breach.²⁸ While nonlegal pressures may encourage Alice to perform,²⁹ neither the law nor considerations of immediate profit or loss push Alice in either direction.

Settlement of disputes takes the time of those involved and may require lawyer participation (and fees), with or without litigation. Even without lawyer participation, the time the parties spend in negotiations must be included as an economic cost of the breach. The only way the cost of settlement will approach zero—and the only way expectancy will be achieved—is if Bob accepts Alice's tender of \$300 and neither party disputes liability or the amount of damages. Thus, in most cases, achievement of expectancy is more fictional than real.

Problem 2. The Seller Recovers. Same basic fact pattern as Problem 1 except that the contract price was \$3,000, the market price was \$2,700, and the buyer, Bob, refused to perform.

In a suit for money damages, Alice would recover \$300.³⁰

Except that the parties are reversed—the buyer rather than the seller breaching—Problem 2 may be analyzed in almost the same lan-

of litigating, will leave the aggrieved party in a better position than if he litigated the case, plus saving the time lost in court.

28. Alice's indifference between paying damages and performing the contract is analogous to the "indifference curves" of economic theory, if she enters a great many contracts and the cost of performance or breach is measured solely in dollars. See P. SAMUELSON, *ECONOMICS* 435-40, 443-48 (10th ed. 1976).

29. See L. FRIEDMAN, *CONTRACT LAW IN AMERICA* 200 (1965); Friedman & Macaulay, *Contract Law and Contract Teaching: Past, Present, and Future*, 1967 *WIS. L. REV.* 805.

A court fight is likely to be inconsistent with continuing business relationships; it makes better economic sense to compromise than to battle through courts if the goodwill or potential profitability of a relationship are worth more than a possible Pyrrhic victory in a lawsuit.

L. FRIEDMAN, *supra* at 200.

30. See *Kudokas v. Balkus*, 26 Cal. App. 3d 744, 753, 103 Cal. Rptr. 318, 323 (1972) (applying the benefit-of-bargain rule in favor of aggrieved vendor of a motel); *F. Poss Farms, Inc. v. Miller*, 35 Colo. App. 152, 154, 529 P.2d 1343, 1344 (1974) (benefit-of-bargain rule for aggrieved vendor of land); *Duffin v. Patrick*, 216 Kan. 81, 82-83, 530 P.2d 1230, 1231-32 (1975) (benefit-of-bargain rule is "settled law in this state"); *Kasten Constr. Co. v. Jolles*, 262 Md. 527, 531, 278 A.2d 48, 51 (1971) (declining to apply good-faith-bad-faith distinction to buyer's breach, although distinction followed by Maryland in cases of seller's breach); *Frank v. Jansen*, — Minn. —, —, 226 N.W.2d 739, 746 (1975); *Thomas F. Ruane Dev. Corp. v. Cullere*, 134 N.J. Super. 245, 252, 339 A.2d 229, 232 (Super. Ct. App. Div. 1975); *Aboud v. Adams*, 84 N.M. 683, 689, 507 P.2d 430, 436 (1973); *Senior Estates, Inc. v. Bauman Homes, Inc.*, 272 Ore. 577, 583-86, 539 P.2d 142, 145 (1975); *Mahoney v. Tingley*, 10 Wash. App. 814, 820, 520 P.2d 628, 633 (1974), *rev'd on other grounds*, 85 Wash. 2d 95, 529 P.2d 1068 (1975).

guage as Problem 1. The market price would be subtracted from the contract price rather than the reverse;³¹ if a specific used car were involved, Uniform Commercial Code section 2-708(1)³² would apply instead of section 2-713(1).

The identity of analysis illustrates the system's consistent goal of eliminating the impact of the breach by elevating the aggrieved party to the position that would have been achieved absent a breach. By compelling the breaching party to pay damages calculated in this way, the system has the effect, if not the purpose, of leaving the breaching party in a similar expectancy position. Both problems involve a breach by the party who made an unfavorable contract; and consequential or incidental damages are not involved in either problem. In each, the costs of litigation or even of settlement would defeat the expectancy goal.

Problem 3. Identical Market and Contract Prices. Same basic fact pattern as Problem 2—the buyer, Bob, breaching—except that the contract price and the market price of the lot were \$3,000.

With the contract price and market price in balance the transaction is neutral in economic terms. Had Bob performed, Alice would have conveyed a \$3,000 lot to Bob in return for a payment of \$3,000. In dollar terms neither Alice nor Bob would have changed position as the result of performance. Since Alice now occupies as good a position without performance as with performance, her recovery would be limited to a nominal amount³³—a token recognizing that a contract was made and was breached.³⁴ The same result follows whichever party breached.

31. See note 30 *supra*.

32. UNIFORM COMMERCIAL CODE § 2-708(1).

33. See *Chesapeake & Potomac Tel. Co. v. Clay*, 194 F.2d 888, 890 (D.C. Cir. 1952) (reducing \$500 award to one dollar nominal damages); *United States v. Thomas B. Bourne Assoc.*, 367 F. Supp. 919, 921 (E.D. Pa. 1973) (donor-promisee of a third-party-beneficiary contract recovers only nominal damages for the promisor's failure to perform); *Huntington Corp. v. Inwood Constr. Co.*, 472 S.W.2d 804, 808 (Tex. Civ. App. 1971, writ ref'd n.r.e.) (\$10 nominal damage award for breach of construction contract); *Shields v. DeVries*, 70 Wash. 2d 296, 301, 422 P.2d 828, 832 (1967) (\$2,000 award reduced to between \$1 and \$25 nominal damages). But see *Thomas F. Ruane Dev. Corp. v. Cullere*, 134 N.J. Super. 245, 252, 339 A.2d 229, 233 (Super. Ct. App. Div. 1975) (aggrieved seller who retains \$17,000 deposit on contract that would have yielded \$5,000 profit not entitled to nominal damages).

34. The term nominal damages means a trivial sum—usually one cent or one dollar—awarded to a plaintiff whose legal right has been technically violated but who has proved no real damage. On the other hand, compensatory damages are awarded to repair the actual damage which the plaintiff proved he suffered at the hands of the defendant. Obviously a plaintiff cannot be entitled to both forms of damages. It is equally obvious that he cannot be awarded the substantial sum of \$500 in the guise of nominal damages

Neither party has any particular economic incentive to perform. Market price being defined as the price at which the lot could be resold in the normal course of events,³⁵ Alice would feel no economic pressure

Chesapeake & Potomac Tel. Co. v. Clay, 194 F.2d 888, 890 (D.C. Cir. 1952).

In discussing nominal damages in *Sweet v. Johnson*, 169 Cal. App. 2d 630, 337 P.2d 499 (1959), the court said:

A plaintiff is entitled to recover nominal damages for the breach of a contract, despite inability to show that actual damage was inflicted upon him . . . , since the defendant's failure to perform a contractual duty is, in itself, a legal wrong that is fully distinct from the actual damages. The maxim that the law will not be concerned with trifles does not, ordinarily, apply to violation of a contractual right. . . .

. . . .
Recognizing these principles of law, defendant concedes that the failure of the trial court to award nominal damages by reason of his breach of contract constituted error. However, he takes the position that if plaintiff is to prevail on appeal he must show that an award of damages is necessary to conserve some permanent right, or that an award of nominal damages would carry costs.

While the general rule is that the failure to award nominal damages is not alone ground for reversal of a judgment or for a new trial . . . , there are exceptions to the rule [one being that] "nominal damages in the given case would carry costs" . . . [and the other being that a nominal damage award] would determine some question of permanent right.

Id. at 632, 337 P.2d at 500-01.

35. [W]hile the worth or value of property is, in one sense of the word, what price it will command on the market, it is a reasonable and equitable proposition that, where damages are sought to be recovered for failure to convey land, its value is not conclusively established by reference to the peak prices or bottom prices of an abnormal, feverish, and fluctuating speculative market, but is rather "the fair value of the property, as between one who wants to purchase and one who wants to sell it—not what it could be obtained for in peculiar circumstances, when greater than its fair price could be obtained; not its speculative value, not the value obtained through the necessities of another. Nor, on the other hand, is it to be limited to that price which the property would bring when forced off at auction under the hammer." *Southern Illinois & M. Bridge Co. v. Stone*, 194 Mo. 175 (92 S.W. 475) [1906]

"Real value" is defined by the Kentucky court as the market value at a sale "under ordinary, normal conditions, unaffected by any combination of producers or dealers whose object is to create an abnormal condition in that market." *Commonwealth v. International Harv. Co.*, 131 Ky. 551 (115 S.W. 703) [1909]. In California it is held that market value is synonymous with actual cash value. *City of Los Angeles v. Western Union Oil Co.*, 161 Cal. 204 (118 Pac. 720) [1911].

In *State v. Parsons*, 109 Mo. App. 432, 440 (84 S.W. 1019) [1905], market value is said to be actual money value, and "is established when other property of the same kind has been the subject of purchase or sale to so great an extent and in so many instances, that the value becomes fixed."

Abrams v. Sinn, 193 Iowa 528, 532-33, 187 N.W. 491, 492 (1922). See also *American Electronics Labs., Inc. v. Dopp*, 369 F. Supp. 1245, 1251 (D. Del. 1974) ("The market value of stock . . . [is] the price that a willing buyer and a willing seller would agree upon . . ."); *Sackett v. Spindler*, 248 Cal. App. 2d 220, 56 Cal. Rptr. 435 (1967) (market price of securities):

"[M]arket price" and "market value" mean the same thing, that is, the price or

to perform,³⁶ although she undoubtedly would prefer to avoid the effort and possible cost of reselling. Bob is free to breach without liability for money damages. As in the first two problems, the Uniform Commercial Code result would be the same.³⁷ Litigation or lawyer-assisted settlement would place both parties in a position worse than if there had been no breach.

Problem 4. A Good Buy. Same basic fact pattern as Problem 2—\$3,000 contract price; \$2,700 market price; the buyer, Bob, breached. A few days before she contracted to sell the lot to Bob, Alice purchased it for \$1,000.

That Alice paid \$1,000 for the lot would not change the result.³⁸ Her expectancy damages remain \$300. Alice retained possession of the lot and by definition could sell it for the market price, \$2,700. Alice would make the same \$2,000 profit if Bob did not breach: \$1,700 on the new sale plus \$300 recovered from Bob.

Land being unique, Alice could not have resold the lot except for Bob's refusal to perform. That Bob's breach made her resale possible is an important element in the analysis. Had the transaction involved goods that were in plentiful supply, Alice's second sale might not have been a resale but a transaction wholly independent of the contract with Bob. In such a case, Alice might be able to invoke section 2-708(2) of the Uniform Commercial Code and recover the difference between the contract price and her cost.³⁹ If the transaction had

value of the article as established or shown by sales in the way of ordinary business [W]hen there is no market available at the time and place of performance . . . resort may be had to the market value of the goods at the nearest available market . . . [or] the difference between the contract price and the value of the goods as best as can be ascertained, or the difference between the contract price and the best offer that can be obtained for the goods, or the difference between the contract price and the price obtained on a resale, or the actual damages naturally and directly resulting from the buyer's breach.

Id. at 236, 56 Cal. Rptr. at 445.

36. See notes 27-29 *supra* and accompanying text. Since market price is defined as the average or usual contract price, see note 35 *supra*, there rarely will be pressure to perform.

37. While the expectancy damage sections, §§ 2-708, 2-713, make no provision for nominal damages, such damages are thought to be available to aggrieved parties. R. NORDSTROM, HANDBOOK OF THE LAW OF SALES 423 (1970).

38. See *Thomas F. Ruane Dev. Corp. v. Cullere*, 134 N.J. Super. 245, 251-52, 339 A.2d 229, 232-33 (Super. Ct. App. Div. 1975) (rejecting vendor's efforts to recover the difference between the contract price and the cost to the vendor of acquiring the property).

39. UNIFORM COMMERCIAL CODE § 2-708(2); see also notes 181-87 *infra* and accompanying text.

involved a specific secondhand car, however, the contract-price-market-price differential would have controlled and Alice would have recovered \$300 without regard to her cost.⁴⁰ In the sense that the resale would not have been possible but for Bob's breach, the specific secondhand car, like the real estate, is unique.

Problem 5. Double Profit? Same basic fact pattern as Problem 2 —\$3,000 contract price; \$2,700 market price; the buyer, Bob, breached —except that two hours after Bob repudiated, Alice sold the lot to Clara for \$3,200.

That Alice resold the lot for \$3,200 would not change the result. Under traditional theory, she would be able to recover \$300 from Bob.⁴¹ While Alice apparently would make a double profit by receiving \$300 from Bob and \$500 over the market price from Clara for the same lot, the traditional expectancy damage rules permit Alice to recover without regard to action taken after breach. Profits from resale do not mitigate her damage award. At common law the market price is established at the time of the breach regardless of who breached,⁴² although subsequent actions such as resale may have an impact—although not controlling—on the determination of market price at the time of breach.⁴³

40. UNIFORM COMMERCIAL CODE § 2-708(1). See *Miller v. Belk*, 23 N.C. App. 1, 5-6, 207 S.E.2d 792, 795 (1974) (denying U.C.C. § 2-706 contract-price-resale-price award and "relegating" the aggrieved seller to the § 2-708(1) contract-price-market-price measure when aggrieved seller of a going business resold after buyer's repudiation and had not satisfied the requirements of § 2-706).

41. See *VanBuskirk v. McClenahan*, 163 Cal. App. 2d 633, 638, 329 P.2d 924, 927-28 (1958) (construing statute to embody common-law rule that aggrieved seller may resell land without thereby reducing allowable damages). But see *Ashurst v. Rosser*, 275 Ala. 163, 168, 153 So. 2d 240, 245 (1963) (excess of resale price over contract price deducted from special damages awarded to aggrieved vendor for costs involved in the resale).

42. See *Royer v. Carter*, 37 Cal. 2d 544, 549, 233 P.2d 539, 542-43 (1951); *Sorenson v. Connelly*, — Colo. App. —, —, 536 P.2d 328, 331 (1975); *Duffin v. Patrick*, 216 Kan. 81, 82, 530 P.2d 1230, 1232 (1975); *Graves v. Winer*, 351 S.W.2d 193, 195 (Ky. 1961); *Frank v. Jansen*, — Minn. —, —, 226 N.W.2d 739, 745 (1975); *Thomas F. Ruane Dev. Corp. v. Cullere*, 134 N.J. Super. 245, 251, 339 A.2d 222, 232 (Super. Ct. App. Div. 1975). For cases involving the sale of goods, see *Martin v. House of Carpets*, 41 Ala. App. 460, 462, 135 So. 2d 171, 173 (1961); *J.M. Rodriguez & Co. v. Moore-McCormack Lines, Inc.*, 32 N.Y.2d 425, 429, 299 N.E.2d 243, 244-47, 345 N.Y.S. 2d 993, 1000 (1973); *Sal's Furniture Co. v. Peterson*, 86 R.I. 203, 210, 133 A.2d 770, 774 (1957); *Rector v. DeArana*, 398 S.W.2d 911, 913 (Tex. 1966). See also *Anderson v. Michel*, 88 Idaho 228, 236, 398 P.2d 228, 233 (1965) (value of property at time of contracting "immaterial").

43. See *Sorenson v. Connelly*, — Colo. App. —, —, 536 P.2d 328, 331 (1975) (resale price of property following breach is evidence of market value); *Duffin v. Patrick*,

Awarding Alice \$300 when she has resold the lot for \$3,200 appears to go beyond her reasonable expectations. But for Bob's breach, Alice would not have been able to sell the lot to Clara. Alice thus made a \$300 profit on her contract with Bob and a \$500 profit on her contract with Clara. The gain on each contract represented Alice's ability or luck in selling subdivision lots. It is at least arguable that Bob is not entitled to an advantage merely because he dealt with a person like Alice who was capable of inducing another to buy the lot at a high price. Alice might achieve a better position than she reasonably could have expected when she contracted with Bob, but, at least arguably, she has earned the double profit.

In any case, requiring Bob to pay \$300 would not penalize him. It would leave him in the same position he would have occupied had he performed—\$300 poorer. In Problem 5, the common-law expectancy system would leave Alice, the injured party, in a better position than she would have achieved had Bob performed, and would leave Bob, the party who breached, in as good—or as bad—a position as if he had performed.

If Problem 5 involved a sale of goods, the Uniform Commercial Code would not vary the common-law result. While section 2-706 of the Code (seller's remedy) and section 2-712 (buyer's remedy) provide measures of damages that take into account the resale or cover price, neither section appears to be mandatory.⁴⁴ If Alice's resale of a used car meets the conditions established in section 2-706⁴⁵ and the price is below market, Alice may take advantage of the situation and recover the larger amount determined by subtracting the below-market resale price from the contract price.⁴⁶ If the resale

216 Kan. 81, 83, 530 P.2d 1230, 1232 (1975); *Sheehy v. Galipeau*, 48 N.J. Super. 95, 102-03, 137 A.2d 5, 10 (Super. Ct. App. Div. 1957) ("the resale price is *prima facie* though not conclusive evidence of the market value").

44. See *Neal-Cooper Grain Co. v. Texas Gulf Sulphur Co.*, 508 F.2d 283, 294 (7th Cir. 1974) (failure to cover does not bar any remedy except consequential damages, citing U.C.C. §§ 2-712, 2-715(2)(a)); *Bache & Co. v. International Controls Corp.*, 339 F. Supp. 341, 352-53 (S.D.N.Y.), *aff'd*, 469 F.2d 696 (2d Cir. 1972) (§ 2-708 benefit-of-bargain award for portion of resale not governed by § 2-706); *Everett Plywood Corp. v. United States*, 512 F.2d 1082, 1092 (Ct. Cl. 1975) (award of benefit-of-bargain against federal government without regard to aggrieved buyer's later purchases); *Miller v. Belk*, 23 N.C. App. 1, 207 S.E.2d 792 (1974) (benefit-of-bargain award to seller who resold without complying with the requirements of § 2-706).

45. UNIFORM COMMERCIAL CODE § 2-706.

46. See *Holiday Mfg. Co. v. B.A.S.F. Systems, Inc.*, 380 F. Supp. 1096, 1105 (D. Neb. 1974); *Bache & Co. v. International Controls Corp.*, 339 F. Supp. 341, 352 (S.D.

is above market, however, as in Problem 5, the seller probably is free to ignore the resale and recover the normal market-price-contract-price differential.⁴⁷ An aggrieved buyer is very likely to have the same options.⁴⁸ If the cover purchase meets the requirements of section 2-712⁴⁹ and is made at a price above market, the buyer may recover the difference between the cover price and the contract price;⁵⁰ if the buyer covers at below market, the buyer probably is free to ignore the cover price and use the market price as the basis of recovery.⁵¹ The Code differs from the common law, however, by fixing the market

N.Y.), *aff'd*, 469 F.2d 696 (2d Cir. 1972); *Alco Standard Corp. v. F & B Mfg. Co.*, 51 Ill. 2d 186, 281 N.E.2d 652 (1972).

47. Whether the draftsmen intended a seller who has resold to recover more in damages under 2-708(1) than he could under 2-706 is not clear. We conclude that he should not be permitted to recover more under 2-708(1) than under 2-706, but we admit we are swimming upstream against a heavy current of implication which flows from the comments and the Code history. Yet 1-106 indicates that a seller who has resold may not invoke 2-708(1). That section states that Code remedies are to put the aggrieved party in as good a position as performance would have, but no better. By hypothesis our seller would recover more under 2-708(1) than he "needs" to make himself whole. Section 1-106 derives faint assistance from the third sentence in Comment 1 to 2-703: "Whether the pursuit of one remedy bars another depends entirely on the facts of the individual case." The comment at least suggests that the seller's use of one remedy may foreclose his use of another. Yet, the immediately preceding sentence in the same comment says: "This Article rejects any doctrine of election of remedy as a fundamental policy and thus the remedies are essentially cumulative in nature and include all of the available remedies for breach."

J. WHITE & R. SUMMERS, *HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE* 223 (1972). See Peters, *Remedies for Breach of Contracts Relating to the Sale of Goods Under the Uniform Commercial Code: A Roadmap for Article Two*, 73 *YALE L.J.* 199, 259-61 (1963).

48. The buyer's option to elect the cover (§ 2-712) or market price (§ 2-713) has given rise to a debate like that concerning §§ 2-706 and 2-708. See J. WHITE & R. SUMMERS, *supra* note 47, at 190-91; Peters, *supra* note 47, at 259-61. It seems clear from the language of the Code and the decided cases that the buyer is under no obligation to cover. See *Neal-Cooper Grain Co. v. Texas Gulf Sulphur Co.*, 508 F.2d 283, 294 (7th Cir. 1974) ("Failure to cover does not bar any remedy except consequential damages"); *Flood v. M.P. Clark, Inc.*, 335 F. Supp. 970, 971 (E.D. Pa. 1971) ("The law is clear that . . . a party is under no obligation to effect cover . . ."). In the *Flood* case, however, the court held that while there was no obligation to cover, if cover is effected, the aggrieved party "may recover as damages only the difference between the cost of his cover and the contract price." The *Flood* case supports the position taken by Professors White and Summers and seems inconsistent with the language and legislative history of the U.C.C.

49. UNIFORM COMMERCIAL CODE § 2-712.

50. *R.L. Pohlman Co. v. Keystone Consol. Indus., Inc.*, 399 F. Supp. 330, 334 (E.D. Mo. 1975).

51. See note 48 *supra*.

price at the time the buyer learned of the breach rather than at the time of the breach.⁵²

The Official Comments to the Code do not explain why the aggrieved buyer or seller may retain any gain resulting from cover or resale while being able to charge to the party who breached any loss resulting from cover or resale.⁵³ Perhaps the drafters of the Code did not want to give the breaching party an advantage resulting from the skill or luck of the aggrieved party in buying below market or selling above market. As at common law, the breaching party is unlikely to receive much sympathy when complaining about a result that leaves her or him in as good—or as bad—a position as if the contract were performed.

Problem 6. A Foolish Move. Same basic fact pattern as Problem 2—\$3,000 contract price; \$2,700 market price—except that the seller, Alice, refused to convey the lot.

Bob would recover nominal damages.⁵⁴ If Bob simply accepted the fact of the breach and took no action, Alice's breach would save Bob \$300. By taking no action after the breach, Bob would return to status quo ante, thereby avoiding the \$300 loss from the unfavorable contract. Alice also would return to her pre-contract position, losing the \$300 she would have gained from performance. If litigation ensued, however, at least part of the \$300 Bob saved as the result of the breach would be dissipated in legal fees; Alice's \$300 loss would be increased by the amount of her litigation expenses.

Expectancy, which dominates the solutions to the first five problems, ceases to be the goal when the person who makes a favorable contract breaches it. If expectancy were the goal, Bob should be required to pay Alice \$300 despite her breach. Nominal damages permit Bob to escape without paying for the mistake he made in entering a losing contract.⁵⁵ A sanction is imposed on Alice by denying her the benefit of the bargain. No comparable sanction is imposed on those who fail to perform contracts unfavorable to them. They are left in as bad a position as if they performed, but they are not necessarily left in a worse position. The system appears to apply pressure to perform on the party who makes a favorable contract.

52. See note 26 *supra*.

53. See notes 7-8 *supra*.

54. See notes 33-34 *supra*.

55. By entering the contract Bob signified his opinion that the property was worth at least as much as the contract price.

Common sense suggests that a person who makes an unfavorable contract is more likely to be disgruntled and, thus, to breach than a person who makes a favorable contract. If the system applies pressure to perform in only one of these situations, it should be on the party most likely to breach. The expectancy damage system does just the opposite.

The nominal damage award in Problem 6 clearly is inconsistent with an expectancy approach, and makes little economic sense.⁵⁶ A reasonable alternative is difficult to suggest. The expectations of the parties would require an award to the party who breached, or an award without regard to fault. Although the courts are understandably reluctant to reward a breaching party, a \$300 award to Alice would reward her not for breaching the contract, but for her sagacity or luck in entering a favorable contract.

Whatever judgment one makes concerning the justification for imposing a sanction—loss of expected profits—on the party who breaches a favorable contract, it is clear that the award of nominal damages leaves both parties in a position inconsistent with the expectancy goal.

Problem 7. The Owner Breaches. Alice, a contractor, and Bob, the owner of a lot, entered a contract under which Alice was to build a house on Bob's lot for \$40,000, payable on completion. When Alice had spent \$11,000 on the job, Bob ordered her to remove her crews and to cease work. Alice did as directed. She filed suit for breach of contract and at trial was able to prove that she could have completed the house at a total cost to her of \$33,000—the \$11,000 already spent plus \$22,000.

If Bob's action amounted to a repudiation, Alice could recover \$18,000.⁵⁷ Had Alice completed the job, her profit would have been \$7,000—the \$40,000 contract price less expenses of \$33,000. Since Alice had spent \$11,000 at the time she was ordered from the job, an \$18,000 award would leave her with her \$7,000 expectancy. When the

56. A nominal damage award for breach of contract is significant only as it carries with it an award of costs or determines some question having a future impact. *Sweet v. Johnson*, 169 Cal. App. 2d 630, 632-33, 337 P.2d 499, 500-01 (1959).

57. See *Robertson v. Ceola*, 255 Ark. 703, 704, 501 S.W.2d 764, 766 (1973) (award in suit by contractor "determined by the formula: contract price minus cost of performance equals profit."); *Crankshaw v. Stanley Homes, Inc.*, 131 Ga. App. 840, 207 S.E.2d 241 (1974); *Peru Assoc., Inc. v. State*, 70 Misc. 2d 775, 777, 334 N.Y.S.2d 772, 776 (N.Y. Ct. Cl. 1971), *aff'd*, 40 App. Div. 2d 589, 335 N.Y.S.2d 373 (1972) (contractor not in default recovers price less cost of performance); *Farris v. Smith Erectors, Inc.*, 516 S.W.2d 281, 283-84 (Tex. Civ. App. 1974).

contractor is the aggrieved party, expectancy damages may be calculated by subtracting the cost to complete from the contract price—here, \$22,000 from \$40,000.⁵⁸ If progress payments have been made, they, too, must be subtracted from the contract price to determine the expectancy award.⁵⁹

Had Alice spent \$15,000 on the job when she was ordered to withdraw, and had the cost of completion been an additional \$30,000, expectancy damages would yield a \$10,000 recovery, \$5,000 less than her cost.⁶⁰ Her position would be the same as if Bob had not breached a contract favorable to him. An expectancy damage suit by Alice in Problem 7, unlike Problem 6, would permit Bob to retain the benefit of the bargain he had made. He would pay \$10,000 for \$15,000 worth of work. A restitutionary remedy⁶¹ would permit Alice to recover any gain Bob might have made on the contract, and would eliminate, as well, any loss she might have suffered.⁶²

On the original facts of Problem 7, Bob, having paid \$18,000 in expectancy damages to Alice, could employ another contractor to complete the house. If he could find someone to complete the job for less than \$22,000, he would pay less for the house than the original \$40,000 contract price. If the new contractor charged more than \$22,000, Bob would pay more than \$40,000 for the house. In economic terms, therefore, Bob would be encouraged to breach if he believed that he could find someone to finish the house for less than \$22,000. And he would be encouraged to perform the original contract if he felt that it would cost him more than \$22,000 to complete it, which is likely to be the case.

A second contractor employed to complete the structure would want a reasonable profit on the balance of the work. Having paid Alice's expected profits on the entire contract, Bob would then have to pay the second contractor's profit on the remaining work. Bob, therefore, would be unlikely to obtain the house for \$40,000 or less, unless Alice's costs were higher than her competitors. In building contracts, unlike sales contracts, the system tends to pressure Bob to perform.

58. See note 57 *supra*.

59. See *Farris v. Smith Erectors, Inc.*, 516 S.W.2d 281 (Tex. Civ. App. 1974).

60. *Id.*

61. See notes 208-19 *infra* and accompanying text.

62. *Id.*

Problem 8. The Contractor Breaches. Same fact pattern as Problem 7—\$40,000 contract; \$11,000 spent by contractor at the time of the breach; a cost to Alice of \$22,000 more to complete the job—except that the contractor, Alice, breached.

Alice breached a contract favorable to her in that, had she completed the job, she would have made a net profit of \$7,000. For Bob to achieve his expectancy, he must receive the house for \$40,000. If after reasonable efforts Bob could not find a second contractor to complete the house for \$40,000 or less, Alice would have to pay Bob the difference between the second contract and \$40,000.⁶³ If Bob could find a second contractor to finish the house for \$40,000 or less, Alice's obligation to Bob would be limited to nominal damages.⁶⁴ Thus, if a second contractor agreed to complete the house for \$30,000, the expectancy damage system would call for a nominal damage award, and Bob would obtain the house for \$30,000 rather than the contracted \$40,000.

Since Alice breached the contract, the expectancy damage system is unavailable to her.⁶⁵ Absent any other remedy she would lose the \$11,000 she had spent before breaching as well as losing her expected profit of \$7,000. Even assuming she could recover under a restitutionary theory as a plaintiff in default,⁶⁶ her maximum recovery would be \$10,000 if Bob's \$30,000 expenditure to complete were reasonable.⁶⁷ An award of more than \$10,000 would force Bob to pay more than \$40,000 for the house, depriving him of his expectancy. At best, Alice

63. See *Bell v. McCann*, — Colo. App. —, —, 535 P.2d 233, 235 (1975) (damages for contractor's failure to complete house equal to difference between contract cost and fair market cost of completion); *Palmer v. Howse*, 133 Ga. App. 619, 619, 212 S.E.2d 2, 3 (1974) ("where a building contract is breached or abandoned . . . the measure of damages is ordinarily the reasonable cost of completion"); *Yonan v. Oak Park Fed. Sav. & Loan Ass'n*, 27 Ill. App. 3d 967, 976, 326 N.E.2d 773, 780-81 (1975) (fair market cost of completion is "consistent measure of damages"); *Louise Caroline Nursing Home, Inc. v. Dix Constr. Corp.*, 362 Mass. 306, 311, 285 N.E.2d 904, 907-08 (1972).

64. Bob paid nothing to Alice and obtained a completed house for less than the \$40,000 contract price; he suffered no damages. See notes 33-34, 63 *supra*.

65. See *Verran v. Blacklock*, 60 Mich. App. 763, 768, 231 N.W.2d 544, 547 (1975). *But see* *Maraldo Asphalt Pav., Inc. v. Harry D. Osgood Co.*, 53 Mich. App. 324, 327-28, 220 N.W.2d 50, 52 (1974) (subcontractor discharged for inadequate performance awarded amount of savings made possible by his breach, denied recovery of full amount of expenses before breach).

66. See notes 220-26 *infra* and accompanying text.

67. See *Maraldo Asphalt Pav., Inc. v. Harry D. Osgood Co.*, 53 Mich. App. 324, 327-28, 220 N.W.2d 50, 52 (1974).

would still lose \$1,000 and her expected profit. Here again, the party who makes a favorable contract is under substantial pressure to perform, with the risk of substantial economic loss accompanying any breach.

2. *The General Rule: Partial Breach*

Problems 1 through 8 illustrate the operation of the expectancy damage system when one party has completely repudiated a contract. The details of the application of the expectancy rules differ somewhat when the breach is partial, but the goal remains the same.

Problem 9. The Slightly Squeezed Lemon. Alice, a used car dealer, and Bob, a schoolteacher, entered into a contract under which Alice was to sell and Bob to buy a used 1971 Buick LeSabre for \$2,900. The market price for the car was \$2,500. Bob paid Alice and took possession of the vehicle. Within a day the car's transmission "froze" and Bob had it repaired for \$250.

If Alice were liable to Bob for breach of an implied warranty of merchantability,⁶⁸ how much would Bob recover under the expectancy system? Had Alice provided a car with a good transmission, Bob would have received a \$2,500 car for the \$2,900 he paid Alice. He would have lost \$400 on the transaction. The car Bob received was worth only \$2,250, however, because of its defective transmission. If Bob were awarded \$250—the difference between the value of the car he was promised (\$2,500) and the value of the car delivered (\$2,250)—he would be left in as good or as bad a position as if Alice had not breached. Section 2-714(2) of the Code codifies the common law in permitting such a value-differential recovery.⁶⁹

68. UNIFORM COMMERCIAL CODE § 2-314.

69. See *Courtesy Ford Sales, Inc. v. Fariior*, 53 Ala. App. 94, 100-01, 298 So. 2d 26, 32 (1974) (value of defect is measure of damages in new-car sale under § 2-714(2)); *Lee v. Air Care, Inc.*, 325 A.2d 598, 599 (D.C. Ct. App. 1974) (award of full price to buyer of air conditioner that expelled warm rather than cool air; defect rendered product valueless); *Louis DeGidio Oil & Gas Burner Sales & Serv., Inc. v. Ace Eng'r Co.*, — Minn. —, —, 225 N.W.2d 217, 222-23 (1974); *Eckstein v. Cummins*, 41 Ohio App. 2d 1, 16, 321 N.E.2d 897, 906-07 (1974) (breach of new-car warranty); *Swenson v. Chevron Chem. Co.*, — S.D. —, —, 234 N.W.2d 38, 44 (1975) (award of full contract price of ineffective insecticide, "worth nothing" because of defect, citing U.C.C. § 2-714(2)). In *Ricklefs v. Clemens*, 216 Kan. 128, 531 P.2d 94 (1975), a stolen car was sold to plaintiff by defendant, who had no knowledge that the car was stolen. The plaintiff kept the vehicle for a long period of time both before and after he was informed by the Federal Bureau of Investigation that the car was stolen. In

The value-differential assessment of damages ignores the spread between market price and contract price. Although Bob would receive \$250 in damages, he would still sustain the \$400 loss resulting from the bad bargain he originally made. Although required to pay \$250 in damages, Alice would retain \$150 of the advantage she gained in making an over-market sale. If Alice had repudiated the contract and refused to deliver the car to Bob, nominal damages would be awarded.⁷⁰ Bob would be relieved of his bad bargain, and Alice would lose the benefit of the bargain she made.

The differing results seem irreconcilable. The value-differential award is within the expectancy framework, while the nominal damage award for total breach ignores expectancy and causes the seller to lose the benefit of her bargain.

Another illustration of the expectancy system's treatment of partial performance is found in construction contract cases. Building contracts, almost by necessity, tend to be performed imperfectly.⁷¹ In response, the expectancy system developed the doctrine of substantial performance for suits "on the contract,"⁷² and "quantum meruit" or "plaintiff-in-default" theories for suits "off the contract."⁷³

Problem 10. The Tar Paper. Alice, a contractor, entered a written agreement with Bob under which Alice agreed to build a house for Bob according to plans and specifications provided by him. The price was set at \$62,500, with progress payments to be made; Bob was to withhold 20%, or \$12,500, until he moved into the house and found that all specifications had been met. Bob moved in but refused to pay the balance to Alice, claiming that Alice had failed to meet the specifications in the following particulars:

assessing damages, the court applied the loss of value test of § 2-714(2), but held that in the circumstances the valuation should have been made as of the time the buyer learned that the car was stolen rather than the time the car was delivered. *See also* Cambern v. Hubbling, — Minn. —, —, 238 N.W.2d 622, 625 (1976) (not exclusive remedy, not applicable to sale of sick calves).

70. *See* notes 33-34 *supra*.

71. *See* Dittmer v. Nokleberg, 219 N.W.2d 201, 206 (N.D. 1974).

72. *See* Lowy v. United Pac. Ins. Co., 67 Cal. 2d 87, 94, 429 P.2d 577, 580-81, 102 Cal. Rptr. 474, 477-78 (1967); Reynolds v. Armstead, 166 Colo. 372, 375-76, 443 P.2d 990, 991-92 (1968) (dicta: contractor's failure to substantially perform deprived him of the right to recover under express contract theory).

73. *See* Nordin Constr. Co. v. City of Nome, 489 P.2d 455, 465-66 n.14 (Alas. 1971) (contractor who fails to perform substantially may recover the value of the "benefit" conferred by partial performance); Kreyer v. Driscoll, 39 Wis. 2d 540, 544, 159 N.W.2d 680, 683 (1968). *But see* Triple M. Roofing Corp. v. Greater Jericho Corp., 43 App. Div. 2d 594, 349 N.Y.S.2d 771 (1973).

- (i) Absence of weather stripping for the cellar door and the windows in the basement and attic;
- (ii) Improper grading of the lot;
- (iii) Failure to provide a screen door for the basement;
- (iv) Leaving a structural defect in the living room ceiling causing it to crack;
- (v) Failure to install solid-core doors throughout the house;
- (vi) Failure to provide a Lodge batting (insulating sheet around the entire house) and substituting two sheets of tar paper in lieu of the Lodge batting.

Alice conceded the defects, and the parties stipulated that it would cost \$9,000 to repair defects (i) through (v); that it would cost \$78,500 to install the Lodge batting because the entire structure would have to be torn down and rebuilt; that it would cost \$4,500 to insulate the house with a foam insulation equivalent to Lodge batting; that the house with all six defects had a market value of \$60,000; that the house without defects and insulated either with Lodge batting or foam would have been worth \$68,000.

If Alice made a "good faith"⁷⁴ effort to perform the contract and if her performance were "substantial,"⁷⁵ she could recover the contract price minus either the cost to complete, *i.e.*, repair the defects,⁷⁶ or the difference in value between the house Bob would have received had Alice performed fully and the house Bob actually received.⁷⁷ The

74. Good faith is often said to be a condition of a finding of substantial performance. See *Lowy v. United Pac. Ins. Co.*, 67 Cal. 2d 87, 92-93, 429 P.2d 577, 580-81 (1967); *Watson Lumber Co. v. Mouser*, 30 Ill. App. 3d 100, 105, 333 N.E.2d 19, 26 (1975); *Gamble v. Woodlea Constr. Co.*, 246 Md. 260, 264, 228 A.2d 243, 245 (1967); *Dittmer v. Nokleberg*, 219 N.W.2d 201, 210 (N.D. 1974); *Perryman v. Sims*, 506 S.W. 2d 753, 756 (Tex. Civ. App. 1974, writ ref'd n.r.e.).

75. See *Nordin Constr. Co. v. City of Nome*, 489 P.2d 455, 458-59 (Alas. 1971).

76. See *Fenner & Shea Constr. Co. v. Wadkins*, 32 Colo. App. 364, 366, 511 P.2d 924, 925 (1973); *Royal Ornamental Iron, Inc. v. Devon Bank*, 32 Ill. App. 3d 101, 108, 336 N.E.2d 105, 111 (1975); *Gamble v. Woodlea Constr. Co.*, 246 Md. 260, 264-65, 228 A.2d 243, 245-46 (1967); *Graham Constr. Co. v. Walker Process Equipment, Inc.*, 422 S.W.2d 478, 480 (Tex. Civ. App. 1967 writ ref'd n.r.e.); *Bolkum v. Staab*, 133 Vt. 467, 470, 346 A.2d 210, 211-12 (1975) (cost-to-repair test in breach of implied warranty on new home); *Stevens Constr. Corp. v. Carolina Corp.*, 63 Wis. 2d 342, 359-60, 217 N.W.2d 291, 300-01 (1974).

77. The value-differential test is applied when the cost to repair the defects is unreasonably high compared with the economic gain that would result. See *Oven Dev. Corp. v. Molisky*, 278 So. 2d 299, 303-04 (Fla. Ct. App. 1973); *Odgers v. Held*, 58 Wash. 247, 251, 362 P.2d 261, 263-64 (1961); *W.G. Slugg Seed & Fertilizer, Inc. v. Paulen Lumber, Inc.*, 62 Wis. 2d 220, 227, 214 N.W.2d 413, 416-17 (1974). See also *Bolkum v. Staab*, 133 Vt. 467, 471, 346 A.2d 210, 212 (1975). (value-differential test

value-differential test normally is used when the economic benefit of making the repairs would be far less than their cost, *i.e.*, when the repairs would amount to economic waste.⁷⁸

As applied to Problem 10, a strict cost-to-repair test would require Alice to pay \$78,500 to install Lodge batting. Because of the economic waste in such repairs and the availability of the cheaper foam alternative, the cost-to-repair formula probably would yield \$4,500 to Bob for the insulation plus \$9,000 for repairing defects (i) through (v), or a total of \$13,500. Since Alice was entitled to the \$12,500 balance of the contract price, her liability to Bob would be the \$1,000 difference between the contract price and the cost to repair.

If all of the repairs were made, the value of the house would be increased only \$8,000. It seems economically wasteful to spend \$13,500 to increase the value by \$8,000. Under the value-differential test, if Alice did perform substantially, Bob's recovery would be limited to \$8,000. Since he otherwise owed Alice the \$12,500 balance of the contract price, Alice would be entitled to a \$4,500 recovery against Bob.

If Alice did not meet the test of substantial performance her right to recover would be "off the contract." Unless Bob were forced to pay the difference between the value of what he received from Alice and the amount already paid, Alice would forfeit the value of the work done and create a windfall for Bob.⁷⁹

Since Bob was the aggrieved party, any recovery by Alice should leave him in no worse a position than he would have occupied had Alice performed as promised. Bob's theory of recovery, whether performance was substantial or less than substantial, remains the same.

In some courts, the damage award arising from the contract in Problem 10 would be the same whether or not the court finds substantial performance.⁸⁰ Without substantial performance Alice would not be entitled to the contract price as a starting point; but Bob's damages remain tied to the contract price. If the value-differential test were used, Bob recovering the \$8,000 difference in value, Alice would be entitled to \$4,500 to avoid a windfall to Bob and a forfeiture by Alice. If the

under an implied warranty of freedom from structural defects in sale of newly constructed homes). In *Dittmer v. Nokleberg*, 219 N.W.2d 201, 203 (N.D. 1974), the syllabus states a general rule that North Dakota courts assess damages in substantial performance cases by the value-differential test.

78. See note 77 *supra*. Problem 10 is patterned after *Glazer v. Schwartz*, 276 Mass. 54, 176 N.E. 613 (1931).

79. See note 73 *supra*; notes 220-26 *infra* and accompanying text.

80. See *Peters v. Halligan*, 182 Neb. 51, 59-60, 152 N.W.2d 103, 109 (1967); *Burke*

\$13,500 cost-to-repair figure were awarded to Bob, he would recover \$1,000 from Alice.

Although many courts sharply distinguish between substantial performance and less than substantial performance, the distinction often has little effect on the amount recovered. Damage awards tend to be the same—although arrived at by different routes—whether or not substantial performance is found.

3. *General Comments on the General Rule*

While the expectancy system is designed to aid the aggrieved party, the system, absent consequential or incidental damages and other complicating factors, often places both the injured party and the breaching party in the position they would have occupied had the contract been performed. The system applies pressure to perform only on the party favored by the contract, the party least likely to breach.⁸¹

While the system tends to take the profit out of breaching, it rarely encourages performance. Having made an unfavorable contract, a party may perform or breach with the same monetary result. Breach well may be more profitable. Because of the cost of litigation, the aggrieved party may settle for less than expectancy, although the breaching party also may have to pay significant legal fees. And, of course, if the market and contract prices are nearly equal—which describes most contracts—only nominal damages are available.

When the parties to a contract desire a continuing relationship—a desire that probably dominates the commercial world—there is substantial empirical evidence that neither side asserts its legal rights.⁸² Each adjusts to the other's problems. Pressure to perform from outside the commercial world is largely unnecessary. It is unlikely that the expectancy system's role is much more significant than providing guidelines for settling disputes when the parties desire a continuing relationship. In this context, the neutrality of the expectancy system seems rational.

v. McKee, 304 P.2d 307, 308-09 (Okla. 1956), both relying on Britton v. Turner, 6 N.H. 481, 26 Am. Dec. 713 (1834). *Contra*, Triple M. Roofing Corp. v. Greater Jericho Corp., 43 App. Div. 2d 594, 349 N.Y.S.2d 771, 773 (1973). RESTATEMENT OF CONTRACTS § 357 (1932) recognizes the right of a plaintiff in default to recover a net benefit conferred on the aggrieved party, but limits the right to cases in which the breach is not "wilful and deliberate."

81. *But see* note 29 *supra*. Transaction costs—overhead, time and effort spent in arranging the original contract—also are wasted if the contract is not performed.

82. *See* note 29 *supra*.

In many cases, however, one or the other of the parties is less interested in a continuing relationship than in the immediate profit to be found in a breach.⁸³ In such cases, performance in the absence of pressure from the legal system or an advantageous contract is unlikely; legal sanctions are necessary to discourage breach. The expectancy damage system provides no such sanction; nor does it encourage performance. In short, the expectancy damage system works well only when it is not needed—in contracts in which commercial pressures for continuing relationships lead the parties to perform or mutually adjust their differences. The system is least satisfactory when it is most needed—when the commercial relationship is subordinate to a quick profit.

In view of its apparent lack of utility, why has the expectancy damage system persisted for so long? Professor Corbin suggests two justifications for the system: keeping the peace, and deterring future breaches.⁸⁴ The “keeping-the-peace” analysis applies to all judicial remedies; contract disputes could be resolved by money damage systems other than the expectancy system. And as noted, the expectancy system rarely deters breach by a party who has made an unfavorable contract, at least absent consequential or incidental damages. In fact, the system may encourage breach by a party who hopes to achieve a favorable settlement.

Another argument in favor of the expectancy system is that a party entering a contract, being assured of receiving the expectancy, is encouraged to engage in other economic activity in reliance on receiving the expectancy.⁸⁵ The argument assumes that the amount of expectancy damages the party will receive are relatively certain, an erroneous assumption in many cases.⁸⁶ Litigation costs and delays also may reduce the net amount received by the aggrieved party. If damages were

83. While continuing relationships tend to dominate many commercial areas, a great many transactions involve speculators only briefly engaged. Most transactions in which one or both of the parties are not “merchants” under the Uniform Commercial Code probably involve casual rather than continuing relationships.

84. 5 A. CORBIN, CORBIN ON CONTRACTS 33-34 (1964).

85. [I]t gradually becomes apparent, upon a broad survey of the law of remedies, that “contracts” are not “enforced” merely because the parties made them, but that the law affords only such remedies for breach of promise as seem most likely to promote the orderly and efficient conduct of the community’s economic life.

Gardner, *An Inquiry into the Principles of the Law of Contracts*, 46 HARV. L. REV. 1, 32 (1932). *But cf.* Birmingham, *Breach of Contract, Damage Measures, and Economic Efficiency*, 24 RUTGERS L. REV. 273, 284-86 (1970).

86. [T]he aim in view is to put the injured party in as good a position as he would have had if performance had been rendered as promised. It goes without saying that this aim can never be exactly attained. The position that one

sufficient to deter breach, the parties could rely on performance rather than a damage award. If damages are too high, however, parties might be deterred from entering contracts at all.⁸⁷ A balance between the extremes should be possible.

The traditional contract-consideration system, including the expectancy component, developed in the late 19th century when laissez-faire was at its height.⁸⁸ In that tradition the goal was to establish a system with a minimum of state intervention.⁸⁹ The fewest possible promises were to be enforced and the smallest possible damages awarded.⁹⁰ Whatever the historical explanation, it is difficult to understand why the damage portion of the system has persisted in the absence of demonstrated commercial utility. One explanation may be that the commercial world still favors minimal government action—an attitude perhaps held by the drafters of the Uniform Commercial Code, which incorporated the expectancy system. Another possibility, suggested by Professor Gilmore, is that the system has not in fact persisted and is now in the process of dying.⁹¹ A final explanation—and perhaps the most accurate—is that no alternative to the traditional expectancy damage system has appeared and that the system persists for the lack of a satisfactory substitute.

III. FORESEEABILITY— CONSEQUENTIAL OR SPECIAL DAMAGES

The consequences of a breach of contract may extend well beyond

would have occupied if history had been different is purely hypothetical. And yet that is the problem that the trial court and jury are required to solve. They must determine what additions to the injured party's wealth (expected gains) have been prevented by the breach and what subtractions from his wealth (losses) have been caused by it. The working rules of law by which court and jury are directed are never capable of exact and perfect application. Not all of the court decisions can be reconciled with any set of rules; and in innumerable cases the courts have seemed to avoid the statement of any rule by which the result reached can be explained.

5 A. CORBIN, CORBIN ON CONTRACTS 5-6 (1964).

87. Hartzler, *The Business and Economic Functions of the Law of Contract Damages*, 6 AM. BUS. L.J. 387, 392 (1968).

88. GILMORE 6-7, quoting L. FRIEDMAN, *CONTRACT LAW IN AMERICA* 20-24 (1965).

89. GILMORE 6-7, quoting L. FRIEDMAN, *supra* note 88, at 94-96.

90. GILMORE 14. Describing the Holmes-Williston view, Gilmore says:

The theory seems to have been dedicated to the proposition that, ideally, no one should be liable to anyone for anything. Since the ideal was not attainable, the compromise solution was to restrict liability within the narrowest possible limits.

Id. See also *id.* at 65-66.

91. See generally GILMORE.

the loss of the contracted performance. The failure of a used car dealer to deliver a \$1,000 car as promised may prevent the buyer from getting his pregnant wife to the hospital in time for the child to be delivered; as a result, the child may die, the mother have a nervous breakdown, and the father take to alcohol and lose his job. If the buyer of the car is to achieve as good a position as if the dealer had delivered the car as promised, an award of something more than the market-price-contract-price differential is necessary. The traditional expectancy system sharply limits awards of such consequential damages through the general rule that the party who breaches a contract is liable only for those damages the parties reasonably should have foreseen on the basis of facts known to them when the contract was made.⁹²

92. See *Lakota Girl Scout Council, Inc. v. Havey Fund-Raising Mgmt., Inc.*, 519 F.2d 634, 640 (8th Cir. 1975) (award of lost profits to charity for breach of contract by fund-raising company); *Spang Indus., Inc. v. Aetna Cas. & Sur. Co.*, 512 F.2d 365, 368 (2d Cir. 1975) (recovery of lost profits); *St. Clair v. Local 515, Teamsters*, 422 F.2d 128, 132 (6th Cir. 1969) (no liability for humiliation and loss of home to mortgage holder, resulting from unfair representation of employee by union); *Walther & Cie v. United States Fidelity & Guar. Co.*, 397 F. Supp. 937, 944-45 (M.D. Pa. 1975) (fluctuation of the German mark was reasonably foreseeable, to be taken into account in assessing damages for failure to pay a sum certain when due); *Alex v. Henry S. Conrey, Inc.*, 380 F. Supp. 1147, 1151-52 (E.D. Pa. 1974), *aff'd*, 511 F.2d 1392 (3d Cir. 1975) (damages limited on ground that action taken and costs incurred after breach were not foreseeable); *Jones Mem. Trust v. Tsai Inv. Servs., Inc.*, 367 F. Supp. 491, 499 (S.D.N.Y. 1973) (only general damages allowed unless special are made known); *Autrey v. Chemtrust Indus. Corp.*, 362 F. Supp. 1085, 1093-94 (D. Del. 1973) (Illinois foreseeability test applied to deny recovery for damages to reputation and loss of good will in a breach of warranty action); *For Children, Inc. v. Graphics Int'l, Inc.*, 352 F. Supp. 1280, 1284 (S.D.N.Y. 1972) (award of lost profits on ground that the parties contemplated retail sale of the entire order); *United States v. Marietta Mfg. Co.*, 339 F. Supp. 18, 24-25 (S.D.W. Va. 1972) (foreseeable consequential damages usually awarded, here denied because of contract provision barring such awards); *Hawkins v. Delta Spindle, Inc.*, 245 Ark. 830, 434 S.W.2d 825 (1968) (applying foreseeability test to deny recovery for loss of use of a machine which the party who breached knew was used for custom harvesting); *A.A. Baxter Corp. v. Colt Indus., Inc.*, 10 Cal. App. 3d 144, 155, 88 Cal. Rptr. 842, 848-49 (1970) (foreseeability test permits assessment of damages for delay in delivering machinery to a subcontractor); *Sears, Roebuck & Co. v. Goudie*, 290 A.2d 826, 832-33 (D.C. Ct. App.), *cert. denied*, 409 U.S. 1049 (1972) (lost profits deemed foreseeable by vendor who knew buyer of inadequate air conditioning system planned to install it in a coffee house); *Olson v. Quality-Pak Co.*, 93 Idaho 607, 610-11, 469 P.2d 45, 48-49 (1970) (contractor liable for delay in construction of a potato cellar which foreseeably caused frost damage to potato crop); *DeWaay v. Muhr*, 160 N.W.2d 454, 459 (Iowa 1968) (breach of contract to plant, grow and deliver popcorn; possibility of lost profits sufficiently foreseeable to present a jury question); *Cain v. Grosshans & Petersen, Inc.*, 196 Kan. 497, 501, 413 P.2d 98, 101-02 (1966) (failure to remove earth from plaintiff's land for use in the construction of a highway; no award for loss of fenced-in lake which performance would have made possible); *State Farm*

The foreseeability limitation on expectancy awards stems from the early case of *Hadley v. Baxendale*,⁹³ which discussed the limitation as follows:

Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive . . . should be such as may fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things, from the breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it.⁹⁴

In explaining why damages were limited to those within the contemplation of the parties at the time of contract, the *Hadley* court said:

[H]ad the special circumstances been known, the parties might have specially provided for the breach of contract by special terms as to the

Gen. Ins. Co. v. Clifton, 86 N.M. 757, 758, 527 P.2d 798, 799 (1974) ("None of the claimed damages were the natural and foreseeable consequences of the claimed breach, and, thus, were not within the contemplation of the parties. Therefore, we hold that an action based on breach of contract does not lie"); Perkins v. Langdon, 237 N.C. 159, 171, 74 S.E.2d 634, 743-44 (1953) (permitting recovery of lost profits in the operation of a tobacco warehouse by plaintiff-lessee who lost the lease as a result of lessor's sale of the warehouse to a third person); Kline Iron & Steel Co. v. Superior Trucking Co., 261 S.C. 542, 548-49, 201 S.E.2d 388, 391 (1973) (common carrier held liable for loss caused by delay in shipment of steel since carrier had notice at time of contract of the need for promptness); Pareira v. Wehner, 133 Vt. 74, 78-79, 330 A.2d 84, 86-87 (1974) (recovery of survey and redesign costs by buyer when seller conveyed less land than promised); Roanoke Hosp. Ass'n v. Doyle & Russell, Inc., 215 Va. 796, 802-03, 214 S.E.2d 155, 160-62 (1975) (interest for added time, but not increase in the interest rate, includible among damages due to contractor's delay in completion); Wilkins v. Grays Harbor Community Hosp., 71 Wash. 2d 178, 187, 427 P.2d 716, 721-22 (1967) (award of \$43,734 for eight-month delay in an operation, breach of medical service plan).

93. 156 Eng. Rep. 145 (Ex. 1854). *Hadley v. Baxendale* and the *Hadley* doctrine are still cited with some frequency. See *Karlen v. Butler Mfg. Co.*, 526 F.2d 1373, 1379 (8th Cir. 1975); *Stanish v. Polish Roman Cath. Union of Am.*, 484 F.2d 713, 724 (7th Cir. 1973); *Dubern v. Girard Trust Bank*, 454 F.2d 565, 568 (3d Cir. 1972); *F.J. McCarthy Co. v. Southern Pac. Co.*, 428 F.2d 690, 693 (9th Cir. 1970); *Crawford v. Pittsburgh-Des Moines Steel Co.*, 386 F. Supp. 290, 294 (D. Wyo. 1974); *Eazor Express, Inc. v. International Bhd. of Teamsters*, 376 F. Supp. 841, 844 (W.D. Pa. 1974); *Walker Mfg. Co. v. Henkel Constr. Co.*, 346 F. Supp. 621, 634-35 (N.D. Iowa 1972); *United States v. Marietta Mfg. Co.*, 339 F. Supp. 18, 24 (S.D.W. Va. 1972); *ERA Helicopter, Inc. v. Digicon Alaska, Inc.*, 518 P.2d 1057, 1060 (Alas. 1974); *Sears, Roebuck & Co. v. Goudie*, 290 A.2d 826, 832 (D.C. Ct. App.), cert. denied, 409 U.S. 1049 (1972); *Strong v. Commercial Carpet Co.*, — Ind. App. —, —, 322 N.E.2d 387, 392 (1975); *Bumann v. Maurer*, 203 N.W.2d 434, 440 (N.D. 1972); *Ligon v. Chas. P. Davis Hardware, Inc.*, 492 S.W.2d 374, 376 (Tex. Civ. App. 1973); *Roanoke Hosp. Ass'n v. Doyle & Russell, Inc.*, 215 Va. 796, 801 n.4, 214 S.E.2d 155, 160 n.4 (1975); *Kentucky Fried Chicken v. Sellaro*, — W. Va. —, —, 214 S.E.2d 823, 828 (1975).

94. *Hadley v. Baxendale*, 156 Eng. Rep. 145, 151 (Ex. 1845).

damages in that case; and of this advantage it would be very unjust to deprive them.⁹⁵

The "special provision" rationale enunciated in *Hadley* contemplates a knowing assumption of the risk. With the necessary information available prior to entering a contract, a party knowing of the potential consequences of a breach will be able to take self-protective action. Such action might involve such things as obtaining or increasing insurance coverage, raising the price, limiting liability by contract, or perhaps simply deciding not to enter the contract.

Expectancy damages are divided into two categories: general and special.⁹⁶ While *Hadley* appeared to lay down a different rule for general and for special damages, the inquiry for both is identical: From facts known before or at the time of entering the contract, what damages should the parties reasonably have foreseen arising from a breach?⁹⁷ As the *Hadley* rule developed, parties who breached were held responsible, not only for consequences actually foreseen at the time of contracting, but also for consequences they reasonably should have foreseen at that time.⁹⁸ American courts took a conservative view of the consequences a person reasonably should have foreseen.⁹⁹ English courts attributed more imagination to the parties.¹⁰⁰

95. *Id.* at 151.

96. The UCC term is "consequential." See note 18 *supra*.

97. See, e.g., *DeWaay v. Muhr*, 160 N.W.2d 454, 459 (Iowa 1968).

98. See *Jones Mem. Trust v. Tsai Inv. Servs., Inc.*, 367 F. Supp. 491, 499 (S.D.N.Y. 1973); *Hunt Bros. Co. v. San Lorenzo Water Co.*, 150 Cal. 51, 56, 87 P. 1093, 1095 (1906); *Wilkins v. Grays Harbor Community Hosp.*, 71 Wash. 2d 178, 186, 427 P.2d 716, 721-22 (1967). See also note 92 *supra*.

99. See *Stanish v. Polish Roman Cath. Union of Am.*, 484 F.2d 713, 724-26 (7th Cir. 1973); *Alex v. Henry S. Conrey, Inc.*, 380 F. Supp. 1147, 1151-52 (E.D. Pa. 1974), *aff'd*, 511 F.2d 1392 (3d Cir. 1975); *Jones Mem. Trust v. Tsai Inv. Servs., Inc.*, 367 F. Supp. 491, 499 (S.D.N.Y. 1973); *Hawkins v. Delta Spindle, Inc.*, 245 Ark. 230, 434 S.W.2d 825 (1968); *F & B Ceco, Inc. v. Galaxy Studios, Inc.*, 201 So. 2d 597, 598-99 (Fla. Ct. App. 1967); *Cain v. Grosshans & Peterson, Inc.*, 196 Kan. 497, 501, 413 P.2d 98, 101-02 (1966); *Baker v. Riverside Church of God*, 61 Tenn. App. 270, 288-91, 453 S.W.2d 801, 809-11 (1970); *New Amsterdam Cas. Co. v. Bettes*, 407 S.W.2d 307, 316-17 (Tex. Civ. App. 1966, writ *ref'd n.r.e.*); *Roanoke Hosp. Ass'n v. Doyle & Russell, Inc.*, 215 Va. 796, 803-04, 214 S.E.2d 155, 161-62 (1975). For expansive applications of the foreseeability doctrine, see *Lakota Girl Scout Council, Inc. v. Havey Fund-Raising Mgmt., Inc.*, 519 F.2d 634, 639-43 (8th Cir. 1975); *Walther & Cie v. United States Fidelity & Guar. Co.*, 397 F. Supp. 937, 944-45 (M.D. Pa. 1975); *For Children, Inc. v. Graphics Int'l, Inc.*, 352 F. Supp. 1280, 1284-85 (S.D.N.Y. 1972); *Sears, Roebuck & Co. v. Goudie*, 290 A.2d 826, 832-34 (D.C. Ct. App.), *cert. denied*, 409 U.S. 1049 (1972).

100. See, e.g., *The Heron II (Koufos v. C. Czarnikow, Ltd.)*, [1967] 3 All E.R. 686 (H.L.); *Victoria Laundry v. Newman Indus. Ltd.*, [1949] 1 All E.R. 997 (Ct. App.).

The drafters of the Uniform Commercial Code adopted the common law's "reason-to-know" doctrine,¹⁰¹ but thought it desirable to modify what they viewed as the "liberality of that rule . . . by refusing to permit recovery unless the buyer could not reasonably have prevented the loss by cover or otherwise."¹⁰² At common law, general damages normally were available without regard to the buyer's "cover" activity,¹⁰³ but special damages were restricted by the foreseeability and mitigation doctrines.¹⁰⁴ It is therefore doubtful that the Code's limitation on consequential damages is more conservative than the rule at common law. The Code does restrict consequential damages to aggrieved buyers, and denies consequential damages to aggrieved sellers,¹⁰⁵ a major departure from the rule of *Hadley*.

Problem 11. Lost Profits. Alice, a manufacturer, and Bob, a jobber, entered a written contract under which Alice agreed to manufacture and sell to Bob, and Bob agreed to buy, 200,000 specially threaded bolts for \$20,000, the market price for such bolts. Delivery was to be made 30 days after the contract was signed. At the time they entered the contract, Alice was aware that Bob had ordered the bolts to fulfill a contractual obligation to Clara to provide the 200,000 specially threaded bolts for \$22,000. Alice repudiated the contract on the day she was to make delivery.

As soon as Bob informed Clara of his inability to deliver the bolts as promised, Clara contracted with an out-of-town manufacturer who agreed to produce and deliver 200,000 specially threaded bolts in 20 days. Clara was forced to pay \$25,000 for the bolts to ensure such

101. UNIFORM COMMERCIAL CODE § 2-715(2).

102. *Id.*, Comment 2.

103. See *Reliance Cooperage Corp. v. Treat*, 195 F.2d 977, 982-83 (8th Cir. 1952) (anticipatory breach by seller of a contract to deliver barrel staves; aggrieved buyer was entitled to the market-price-contract-price differential as of the date the seller should have performed although the aggrieved buyer took no action upon learning of the repudiation); *Continental Grain Co. v. Simpson Feed Co.*, 102 F. Supp. 354, 363-64 (E.D. Ark. 1951), modified on other grounds, 199 F.2d 284 (8th Cir. 1952) (market-price-contract-price award despite absence of cover efforts).

104. See *Stanley v. Tinsman*, 159 Me. 17, 18-19, 187 A.2d 401, 403 (1963); *Rich v. Bongiovanni*, 4 N.J. Super. 243, 247-50, 66 A.2d 888, 891-92 (Super. Ct. App. Div. 1949); *Sellers v. Orona*, 58 N.M. 53, 54-55, 265 P.2d 369, 370-71 (1954); *Czarnikow-Rionda Co. v. Federal Sugar Refining Co.*, 255 N.Y. 33, 42-47, 173 N.E. 913, 915-17 (1930).

105. Section 2-715 applies only to buyer's remedies and the Code contains no comparable consequential-damage provision relating to the seller. Section 1-106 appears to restrict consequential damages to those authorized by § 2-715: "[N]either consequential or special . . . damages may be had except as specifically provided in this Act or by other rule of law." UNIFORM COMMERCIAL CODE § 1-106.

rapid delivery. As the result of the temporary bolt shortage, Clara was forced to close her plant for 15 days and lost \$40,000 in profits. When Bob contracted with Clara, he knew she had few bolts on hand and understood that if he failed to supply the bolts as promised, it was likely that she would be forced to shut down production. Alice was unaware of the bolt shortage until after she repudiated the contract.

If the contract between Alice and Bob were viewed in isolation, Bob would be entitled to nominal damages, the market and contract prices being the same.¹⁰⁶ The second contract between Bob and Clara, however, complicates the analysis. Had Alice performed as promised, Bob would have made a \$2,000 profit from his resale to Clara. When she agreed to manufacture the bolts, Alice knew of Bob's obligation to Clara, and so would be liable to Bob for the \$2,000 loss of profits, under the common law test¹⁰⁷ or the consequential damage test of section 2-715(2) of the Code.¹⁰⁸ Apart from Bob's possible liability to Clara, the \$2,000 award would put him in as good a position as if Alice had performed.

Whether Alice would view her breach as costly would depend on whether she could have produced the bolts for more or less than \$22,000. If Alice's cost to manufacture the bolts were \$1,000 less than

106. See note 33 *supra*.

107. See *Tomlinson v. Wander Seed & Bulb Co.*, 177 Cal. App. 2d 462, 472, 2 Cal. Rptr. 310, 316 (1960) (resale by purchaser within contemplation of both parties, failure of seller to deliver causes loss of prospective profits); *Smith v. A.A. Wood & Son Co.*, 103 Ga. App. 802, 809, 120 S.E.2d 800, 805 (1961) (dicta: lost profits may constitute a proper element of damages if when the contract was made they were within the contemplation of the parties as a probable result of the breach); *Jennings v. Lamb*, 201 Tenn. 1, 7-8, 296 S.W.2d 828, 831 (1956) (knowledge that buyer is a dealer in the goods being sold sufficient to charge breaching seller with special damages based on lost resales). See also *Narried v. Johnson*, 339 S.W.2d 566 (Tex. Civ. App. 1960):

The law in Texas is well settled that, where the buyer of productive machinery is prevented or incapacitated from doing business for a considerable period of time by reason of seller's failure to make delivery within the time agreed upon, he can recover any lost profits that were within the contemplation of the parties and which can be established with requisite certainty.

Id. at 568.

108. See *Hoeffler Truck Sales v. Divco-Wayne*, 523 F.2d 543, 550-51 (7th Cir. 1975) (automobile dealers awarded lost resale profits resulting from the failure of a truck manufacturer to deliver trucks); *Lake Village Implement Co. v. Cox*, 252 Ark. 224, 230-31, 478 S.W.2d 36, 41-42 (1972); *Matsushita Elec. Corp. of Am. v. Sonus Corp.*, 362 Mass. 246, 262-64, 284 N.E. 880, 889-90 (1972); *Gulf Chem. & Metal Corp. v. Sylvan Chem. Corp.*, 122 N.J. Super. 499, 505-06, 300 A.2d 878, 882 (Super. Ct. L. Div.), *aff'd*, 126 N.J. Super. 261, 314 A.2d 73 (Super. Ct. App. Div. 1973); *Harbor Hill Litho. Corp. v. Dittler Bros., Inc.*, 76 Misc. 2d 145, 146-48, 348 N.Y.S.2d 920, 923-24 (Sup. Ct. 1973).

the \$20,000 contract price, her breach would cost her the \$1,000 profit she would have made plus the \$2,000 consequential damage award to Bob, or a total of \$3,000. If her costs to produce the bolts were \$22,000, performance would bring the same loss she would have suffered by paying the \$2,000 to Bob. And if her costs of production were \$25,000, Alice's profit from her breach would be \$3,000. She would have saved a \$5,000 loss by refusing to fulfill her commitment to Bob, at the expense of a \$2,000 award of consequential damages to Bob. The system would encourage Alice to breach.

Alice's breach, however, would cause Bob a loss substantially in excess of \$2,000. Bob's failure to deliver the bolts to Clara forced her to the open market where, acting reasonably, she covered for \$25,000, or \$3,000 more than the \$22,000 price she was to pay to Bob. Under section 2-712 of the Code, Bob would be liable to Clara for the \$3,000 difference between the cover price and the contract price.¹⁰⁹ Could Bob recover this \$3,000 from Alice? Section 2-715(2) of the Code would permit Bob to recover "any loss resulting from . . . particular requirements and needs of which . . . [Alice] at the time of contracting had reason to know . . ." ¹¹⁰ At the time of contracting, Alice knew that Bob had contracted to resell the bolts to Clara and that the bolts were specially threaded and thus unlikely to be readily available. She did not know that Clara's inventory of bolts was extremely low. Under section 2-715,¹¹¹ Bob probably could recover the \$3,000 from Alice, if Alice knew or had reason to know that Bob would be liable for Clara's extra costs in obtaining replacement bolts. The assumption is that Alice would have known that Bob would be liable to Clara for reasonable action Clara took to acquire substitute bolts. (Under the common law the result would have been less certain.)¹¹² If Alice were aware of the potential cost of breach, the system would tend to deter Alice from breaching even when she made an unfavorable contract, unless, of course, the contract was so unfavorable that it would cost her more than \$25,000 to produce the bolts.

Bob may be liable to Clara for more than \$3,000.¹¹³ When he contracted with Clara, Bob knew of the short supply of bolts she had

109. UNIFORM COMMERCIAL CODE § 2-712.

110. UNIFORM COMMERCIAL CODE § 2-715(2)(a).

111. See note 108 *supra*.

112. See notes 107-08 *supra*.

113. See note 107 *supra*.

on hand and understood the likelihood of a shutdown if he failed to supply the bolts as promised. With such knowledge Bob probably would be liable to Clara for the \$40,000 loss she suffered as the result of shutting down production.¹¹⁴

An award of \$43,000 to Clara would meet her expectancy in her contract with Bob. For Bob to achieve his expectancy, however, he should recover \$45,000 from Alice—\$2,000 in lost profits and \$43,000 in damages to Clara. It is extremely unlikely that Alice would be liable to Bob for Clara's \$40,000 in lost profits. Alice was unaware of the bolt shortage when she contracted with Bob, and consequently had no reason to believe that Clara would be forced to shut down production.¹¹⁵

Bob probably would recover \$5,000 from Alice and pay Clara \$43,000 in damages. Clara would receive her expectancy; Alice would suffer a mild loss from breaching, the extent of her loss depending on whether she had a favorable or unfavorable contract with Bob. Bob, as the aggrieved party in his contract with Alice and the breaching party in his contract with Clara, would suffer a severe loss because his knowledge base was broader than Alice's.

Because the consequential damage portion of the system depends on foreseeability, an aggrieved party such as Bob may suffer substantial uncompensated losses because of another's breach. Alice's foresight—not Bob's—limits the amount of recovery. Although it is often said that the expectancy damage system is not penal, the foreseeable-consequences portion of the system imposes a sanction on the aggrieved party for failure to make known the consequences of a breach. Unless the information necessary to support liability is made known before or at the time of contracting, the party aggrieved by the breach will not be compensated fully for the loss suffered. The foreseeability limitation thus often inhibits the goal of putting the aggrieved party in as good a position as if the contract were performed. With the limitation, the system often fails to compensate the aggrieved party for losses suffered; the system limits damages to an amount the breaching party might anticipate if that party had speculated about damages when the contract was made.

114. The issue, of course, is whether Bob's knowledge was such that he should be charged with full damages.

115. See note 106 *supra* and accompanying text.

IV. MITIGATION—POST-BREACH DUTIES OF THE AGGRIEVED PARTY

The mitigation doctrine is an integral part of the traditional expectancy damage system. Under the doctrine, breach of contract—while it may relieve the nonbreaching party of further obligation to perform as promised¹¹⁶—imposes two duties on such an aggrieved party: First, to take all reasonable action to reduce damages (to mitigate);¹¹⁷ and

116. See RESTATEMENT OF CONTRACTS ch. 11 (1932).

117. See *McCurin v. Kohlmeyer & Co.*, 477 F.2d 113, 116 (5th Cir. 1973) (customer's suit against broker for buying cotton futures for customer's account above the price authorized by the customer; mitigation accomplished by customer's prompt direction that the futures be sold); *Gurney Indus., Inc. v. St. Paul Fire & Marine Ins. Co.*, 467 F.2d 588, 596-97 (4th Cir. 1972) (breach of contract to build a yarn-spinning mill for plaintiff; plaintiff mitigated by permitting supplier's employees to attempt to make the equipment work); *KLPR TV, Inc. v. Visual Electronics Corp.*, 465 F.2d 1382, 1388 (8th Cir. 1972) (UCC case in which consequential damages were denied on the ground that lessee of TV equipment failed to take reasonable steps to minimize damages); *Courtlund v. Walston & Co.*, 340 F. Supp. 1076, 1079-80 (S.D.N.Y. 1972) (investor barred from claiming damages resulting from a stockbroker's failure to buy shares as instructed; investor was obliged to mitigate by buying the shares elsewhere); *Wurlitzer Co. v. Oliver*, 334 F. Supp. 1009, 1012 (W.D. Pa. 1971) (UCC case in which vendor who resold items as a unit rather than separately was held to have acted in good faith for the purpose of realizing "the greatest sum to be applied in mitigation of damages"); *United States v. Stack*, 308 F. Supp. 46, 49 (E.D. Va. 1968), *aff'd*, 420 F.2d 698 (4th Cir. 1970) (contract to clear land in Arlington National Cemetery; subcontractor who made no effort to remove and sell felled logs not permitted to claim lost profits from contemplated sale of logs); *C.J. Langenfelder & Son, Inc. v. United States*, 384 F.2d 1005, 1006-07 (Ct. Cl. 1967) (mitigation duty does not require a contractor to take impractical and uneconomical steps to convert unsuitable soil into useful material); *Madison County Bd. of Educ. v. Wigley*, 288 Ala. 202, 210, 259 So. 2d 233, 239 (1972) (tenure statute relieves teacher, dismissed in violation of statute, of obligation to seek other employment to mitigate damages); *University of Alaska v. Chauvin*, 521 P.2d 1234, 1239-40 (Alas. 1974) (teacher dismissed from tenured position required to seek alternative employment); *Coury Bros. Ranches, Inc. v. Ellsworth*, 103 Ariz. 515, 520, 446 P.2d 458, 461 (1968) (lessee obliged to seek alternative sources of barley and wheat after learning of breach of pasturage contract); *Wawak v. Stewart*, 247 Ark. 1093, 1103, 449 S.W.2d 922, 927 (1970) (damages for water seepage reduced because owner did not permit contractor to install an automatic sump pump which would have reduced damages, but would not have eliminated the problem); *Cherokee Inv. Co. v. Voiles*, 166 Colo. 270, 277, 443 P.2d 727, 730 (1968) (buyers of defective water conditioner satisfied the duty to mitigate by repeated efforts to persuade the seller to repair); *Nash v. Hoopes*, 332 A 2d 411, 414 (Del. Super. Ct. 1975) (buyer's reasonable efforts to find financing for replacement purchase sufficient to sustain award of lost profits on seller's breach of land contract); *Katz v. Exclusive Auto Leasing, Inc.*, 282 A.2d 866, 868 (Del. Super. Ct. 1971) (evidence about car leasing company's disposition of car returned to the lessor before expiration of lease held admissible); *Industrial Leasing Corp. v. Thomason*, 96 Idaho 574, 578, 532 P.2d 916, 919-20 (1974) (lessor of farm equipment had a duty to

second, to refrain from taking action to increase damages (to avoid

make commercially reasonable efforts to re-lease the equipment during the balance of the term of the lease); *Theis v. du Pont, Glore Forgan Inc.*, 212 Kan. 301, 308, 510 P.2d 1212, 1217-18 (1973) (customer suing broker for unauthorized transactions on customer's account was not required to go into the market in an attempt to minimize damages); *Whitley County Bd. of Educ. v. Meadors*, 444 S.W.2d 890, 891-92 (Ky. 1969) (wrongfully discharged school teacher did not have to seek other employment in the circumstances); *Volos, Ltd. v. Sotera*, 264 Md. 155, 176-77, 286 A.2d 101, 111-12 (1972) (discharged employee used reasonable efforts to obtain other employment and thus satisfied the mitigation requirement); *Frank v. Jansen*, — Minn. —, —, 226 N.W.2d 739, 740 (1975) (expenses incurred in mitigation may be added to damages awarded on breach of contract for sale of house); *Stevens v. School Bd.*, 296 Minn. 413, 415-16, 208 N.W.2d 866, 868 (1973) (wrongfully discharged school teacher must mitigate damages by seeking other employment; job so obtained does not constitute waiver of the teacher's claim); *Wolf v. Missouri State Training School for Boys*, 517 S.W.2d 138, 142-44 (Mo. 1974) (wrongfully discharged employee's recovery reduced by amount the employee reasonably could have earned during the period of discharge); *Business Fin. Co. v. Red Barn, Inc.*, 163 Mont. 263, 267-68, 517 P.2d 383, 386 (1973) (during 17 months of breach, lessor acted reasonably by giving frequent default notices to lessee, need not have repossessed business machines); *Little v. Rose*, 285 N.C. 724, 729-30, 208 S.E.2d 666, 669-70 (1974) (buyer's reasonable reliance on seller's assurances relieves buyer of obligation to repair machinery); *Tomlinson Lumber Yard v. Engle*, 216 N.W.2d 87, 89-90 (N.D. 1974) (owner, by preventing contractor from completing bar, failed to mitigate damages); *Schafer v. Sunset Packing Co.*, 256 Ore. 539, 542-43, 474 P.2d 529, 530-31 (1970) (grower acted reasonably in relying on labor contractor's assurances, refusing contractor's modified offer; grower relieved of duty to take action to mitigate); *Ivester v. Family Pools, Inc., Bosco Indus.*, 262 S.C. 67, 202 S.E.2d 362 (1974) (owner of a swimming pool left incomplete by the contractor not required to mitigate damages by completing pool); *Ferrell v. Elrod*, 63 Tenn. App. 129, 157, 469 S.W.2d 678, 689 (1971) (lessee, seeking lost profits resulting from breach of the lease, required to minimize damages by making reasonable efforts to find substitute premises); *Houston Chronicle Pub. Co. v. McNair Trucklease, Inc.*, 519 S.W.2d 924, 929-31 (Tex. Civ. App. 1975, writ ref'd n.r.e.) (breach of truck purchase contract; recovery of investment and lost profits after mitigation); *Salt Bowl Co. v. State*, — Utah —, —, 535 P.2d 1253, 1256 (1975) (plaintiff's five-year lease of the state fairgrounds for automobile racing was terminated on the stated ground that the racing violated Salt Lake City's noise ordinance. Plaintiff's refusal to accept the state's invitation to test the noise ordinance by running cars on the track was established as the point in time at which plaintiff's damages were cut off, its refusal being deemed in violation of its obligation to "exert reasonable and prudent efforts to mitigate its damages"); *Sheldon v. Northeast Developers, Inc.*, 127 Vt. 15, 18, 238 A.2d 775, 776-77 (1968) (offer by contractor to make repairs relieves homeowner from duty to act to mitigate damages by making repairs "for at least as long as the plaintiff was reasonably entitled to expect the defendant might act"); *Valiga v. National Food Co.*, 58 Wis. 2d 232, 244, 206 N.W.2d 377, 384 (1973) (UCC case involving breach of warranty in sale of mink food; the food inhibited the minks' breeding ability. Buyers decided to sell the "breeder" minks for their pelts and the vendor challenged their action. The court said: "The test should not be whether the actions of the plaintiffs, in attempting to mitigate their damages, were right or wrong, but rather whether they were reasonable").

harm).¹¹⁸ To the extent the mitigation doctrine reduces damages, it also reduces pressure to perform.

A. *Avoidable Harms*

Problem 12. Failing to Stop Building. Alice, a contractor, and Bob, the owner of a lot, entered a contract under which Alice was to build a house on Bob's lot for \$40,000, payable on completion. When Alice had spent \$11,000 on the job, Bob ordered her to remove her crews and to cease work. Alice refused to stop and completed the house at a total cost to her of \$33,000—the \$11,000 already spent plus \$22,000 spent after Bob directed her to stop.

By going forward after being told to stop, Alice breached her duty to refrain from taking action to increase damages. Had Alice stopped as directed, an \$18,000 award would have left her with her expectancy—a \$7,000 profit plus the \$11,000 she had spent.¹¹⁹ By completing the house at a total cost of \$33,000, Alice raised to \$40,000 the award necessary to leave her with a \$7,000 profit. If Bob were required to pay \$40,000, Alice would still have a \$7,000 profit, but Bob would have to pay \$40,000 rather than \$18,000 to permit Alice to achieve that position. Thus, Alice's act in completing the house would gain her nothing but would cost Bob a substantial amount. The avoidable-harms element of the mitigation doctrine would limit Alice's recovery to \$18,000 because Alice breached her duty to refrain from taking affirmative action to increase Bob's damages. In getting the completed house for \$18,000, Bob would receive a substantial windfall, albeit one he might not want. Alice, instead of having a \$7,000 profit, would

118. See *Rockingham County v. Luten Bridge Co.*, 35 F.2d 301, 307 (4th Cir. 1929) (contractor, notified that county was cancelling contract to build a bridge, could not proceed to build the bridge and recover the contract price); *Eazor Express, Inc. v. International Bhd. of Teamsters*, 376 F. Supp. 841, 849 (W.D. Pa. 1974), *modified by increasing damages awarded*, 520 F.2d 951 (3d Cir. 1975) (suit against union for failure to use all reasonable efforts to terminate a wildcat strike, employer's damages were limited because of its failure to act reasonably to bring the strike to an end); *Clark v. Marsiglia*, 1 Denio 317, 43 Am. Dec. 670 (N.Y. 1845) (aggrieved party's failure to obey order to stop work, which order was a breach of contract, held not to increase damages payable by the party who breached, the damages awarded being the amount the aggrieved party would have recovered had the order to stop been obeyed); *Tower Contracting Co. v. Flores*, 294 S.W.2d 266, 273-74 (Tex. Civ. App. 1956), *rev'd on other grounds*, 157 Tex. 297, 302 S.W.2d 396 (1957) (contractor prevented from recovering the contract price when it continued to perform after being informed that the contract was cancelled; supreme court approved lower court's holding on the avoidable-harms issue).

119. See note 118 *supra*.

lose \$15,000—a \$22,000 swing. By going forward in the face of Bob's directive to stop, Alice, the party initially aggrieved by Bob's repudiation, would occupy a far worse position than she would have achieved had both parties performed their contractual obligations; and Bob, who breached, would be in a far better position.

Both parties breached duties—Bob, his contract duty, and Alice, her duty to avoid increasing Bob's damages. In balancing the equities, the system apparently deems Alice's breach of duty as more serious than Bob's; Bob is treated as more aggrieved than Alice. The system, supposedly nonpenal,¹²⁰ imposes a severe penalty on Alice for building the house as she promised.¹²¹

In support of the avoidable-harms portion of the mitigation doctrine, it may be argued that the law should not permit useless acts; that Alice's act in completing the house after repudiation is useless in that it increases Bob's total damage payment without any gain to Alice; that any such result is inconsistent with the compensatory nature of contract

120. See *Davis Cattle Co. v. Great Western Sugar Co.*, 393 F. Supp. 1165, 1196 (D. Colo. 1975) (no exemplary damages for bad-faith or gross-mistake breach of contract). See also *Food Fair Stores, Inc. v. Hevey*, 275 Md. 50, 53-54, 338 A.2d 43, 45 (1975) (when "the tort is one arising out of a contractual relationship . . . punitive damages are recoverable only upon a showing of actual malice"); *Progressive Cas. Ins. Co. v. Keys*, 317 So. 2d 396, 398 (Miss. 1975) ("[p]unitive damages are not recoverable for the breach of a contract unless such breach is attended by intentional wrong, insult, abuse or such gross negligence as to consist of an independent tort"); *Bank of New Mexico v. Rice*, 78 N.M. 170, 429 P.2d 368 (1967) (bank which breached a contract to advance funds held liable for punitive damages on a finding that the bank had acted with malice).

121. The avoidable harms and mitigation doctrine—or, perhaps, doctrines—are referred to in the present article as imposing a "duty" on and as "penalizing" the aggrieved party. The failure to take reasonable action to decrease damages and the taking of affirmative action which increases damages are thought to violate the "right" of the party who breached to pay the minimum amount of damages caused by the breach. And to the extent that the aggrieved party receives a smaller amount of damages than otherwise, the aggrieved party is being penalized for failing to take reasonable action to mitigate or for taking affirmative action which increases the amount of damage suffered. The use of the terms "duty" to mitigate and "penalty" for failure to mitigate is rejected by several commentators and cases. See, e.g., *McClelland v. Climax Hosiery Mills*, 252 N.Y. 347, 169 N.E. 605, *modified*, 253 N.Y. 534, 171 N.E. 770 (1930):

What is meant by the supposed duty is merely this: That if he unreasonably reject [other employment] he will not be heard to say that the loss of wages from then on shall be deemed the jural consequence of the earlier discharge. He has broken the chain of causation, and loss resulting to him thereafter is suffered through his own act.

Id. at 359, 169 N.E. at 609 (Cardozo, J.). See also *Coury Bros. Ranches, Inc. v. Ellsworth*, 103 Ariz. 515, 518, 446 P.2d 458, 461 (1968); *Theis v. du Pont, Glore Forgan, Inc.*, 212 Kan. 301, 307, 510 P.2d 1212, 1217 (1973); RESTATEMENT OF CONTRACTS § 336, Comment d (1932); 5 A. CORBIN, CORBIN ON CONTRACTS § 1039 (1951); 11 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 1353 (3d ed. W. Jaeger 1968).

damages and penalizes Bob to no purpose.¹²² The doctrine is also consistent with Holmes' notion that either party to a contract has the right as well as the power to breach and to substitute money damages for performance.¹²³ Breach may be "honorable" if the party who breaches does so because funds will not be available to pay the full contract debt. In economic terms, if Bob determines that the money committed to the contract project has other more valuable uses, logic dictates that he repudiate and pay a relatively small amount for the privilege of using the funds more profitably. Finally, as noted in the discussion of Problem 7, if Bob can obtain the services of another contractor to complete the house for less than \$22,000, requiring Alice to stop does her no economic harm, while employing another contractor to complete the house makes economic sense from Bob's perspective.

Accepting all arguments in favor of an \$18,000 award to Alice in Problem 12, the fact remains that Bob, although he repudiated the contract, now has a house that cost \$33,000 to build, for which he paid only \$18,000. If the house has a market value of \$40,000, and Bob sells the house at market, it would be reasonable to require Bob to return some of that money to Alice.¹²⁴ If he is required to pay her \$15,000 in addition to the \$18,000 damage award, Alice will be left with no out-of-pocket loss and Bob will retain a \$7,000 windfall—the profit Alice would have made but for Bob's breach and her own breach of her duty to avoid increasing damages. If such an adjustment is made, the system, by denying profit to Alice, would pressure her to stop as directed, but would limit the sanction imposed on Alice to her loss of profits. Such a result is consistent with the usual result when a person who made a favorable contract breaches that contract.

122. A man may hire another to labor for a year, and within the year his situation may be such as to render the work entirely useless to him. The party employed cannot persist in working, though he is entitled to the damages consequent upon his disappointment. So if one hires another to build a house, and subsequent events put it out of his power to pay for it, it is commendable in him to stop the work, and pay for what has been done and the damages sustained by the contractor.

Clark v. Marsiglia, 1 Denio 317, 319, 43 Am. Dec. 670, 671 (N.Y. 1845).

123. The only universal consequence of a legally binding promise is, that the law makes the promisor pay damages if the promised event does not come to pass. In every case it leaves him free from interference until the time for fulfillment has gone by, and therefore free to break his contract if he chooses.

O. HOLMES, THE COMMON LAW 236 (M. Howe ed. 1963).

124. In *Tower Contracting Co. v. Flores*, 294 S.W.2d 266, 273 (Tex. Civ. App. 1956), *rev'd on other grounds*, 157 Tex. 297, 302 S.W.2d 296 (1957), a contractor who proceeded with a construction project after having been directed by the owner to stop would have been permitted to recover on a *quantum meruit* theory for the value of the service actually rendered had such a count been included in the contractor's pleading.

Problem 13. The Special Chair. Alice employed 20 persons in a small shop which hand-crafted furniture. She entered a written contract with Bob to build a wooden chair for him for \$900. Had the chair been completed, Alice's profit would have been \$300. (Her material, labor and overhead costs would have totalled \$600). When Alice's material, labor and overhead costs on the chair came to \$200, Bob repudiated and directed that all work on the chair stop. At the time of breach, the partially completed chair had a market value—scrap or salvage—of \$25. Had the chair been completed, it would have had a market value of \$800.

While the facts of Problem 13 probably would bring the case within the Uniform Commercial Code,¹²⁵ the result under the Code and at common law would be similar. If Alice stopped work on the chair as directed, it would have taken \$475 to provide her with her expectancy, a \$300 profit.¹²⁶ Alice spent \$200 and had a partially completed chair with scrap or salvage value of \$25¹²⁷—a net out-of-pocket expense of \$175. A \$475 award would reimburse Alice for these expenses and leave her with her \$300 expectancy profit. (The same result is reached by applying the formula: \$900 contract price minus \$400 cost to complete minus \$25 expenses saved.)

If Alice disregarded Bob's direction to stop work and completed the chair, her expectancy would be achieved by an award of \$100. By definition, Alice could have sold the chair for the market price, \$800.¹²⁸ With a contract price of \$900, a total cost (materials,

125. See UNIFORM COMMERCIAL CODE §§ 2-102 ("this Article [Sales] applies to transactions in goods . . ."), 2-105(1) ("['g]oods' mean all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale . . ."). See, e.g., *Bonebrake v. Cox*, 499 F.2d 951, 958 (8th Cir. 1974).

126. It is difficult to know which section of the Uniform Commercial Code would apply to the facts of Problem 13. If the specially made chair has no ascertainable market price, § 2-708(2) probably would apply, and Alice would recover \$475. Section 2-708(2) applies only if the contract-price-market-price formula of § 2-708(1) "is inadequate to put the seller in as good a position as performance would have done . . ." In the absence of a reliable market price figure, § 2-708(1) would not put Alice in as good a position as performance. Under § 2-708(2), Alice would recover the profit she would have made from full performance plus the costs she had reasonably incurred minus the amount received for the scrap value of the chair. See *Detroit Power Screw-driver Co. v. Ladney*, 25 Mich. App. 478, 181 N.W.2d 828 (1970).

127. See UNIFORM COMMERCIAL CODE § 2-704(2).

128. See *J.M. Huber Corp. v. Denman*, 367 F.2d 104, 109 (5th Cir. 1966) (in determining market price, "the law looks [to] . . . the supposed free seller . . . [and] free buyer dealing freely at arm's length supposedly in relation to property which neither will ever own, buy or sell"). The Minnesota supreme court discussed market value in *Lehman v. Hansord Pontiac Co.*, 246 Minn. 1, 74 N.W.2d 305 (1955):

It is established in the law generally that the market value of a thing is what

labor and overhead) of \$600 and a market price of \$800, a \$100 award would have given Alice her \$300 expectancy profit.

The damages would have been increased by \$375 had Alice followed Bob's instructions to stop work on the chair. Going forward would not be a useless act. In such circumstances, both the common law and the Uniform Commercial Code would allow the injured party to ignore the stop order and complete performance if the decision to do so were based on a reasonable judgment that going forward would probably decrease the damages arising from the breach.¹²⁹ If the decision to go forward were a commercially reasonable judgment, the risk of increased damages would fall on the party who breached.¹³⁰ Thus, if Alice reasonably decided that completing the chair would reduce damages, and she sustained greater damages due to a falling market or un-

it will bring in the open market, the price which the owner, if willing but not compelled to sell, could obtain from a buyer, willing but not compelled to buy. It has also been defined as a price established by public sales in the way of ordinary business

Id. at 8, 74 N.W.2d at 310. See also UNIFORM COMMERCIAL CODE §§ 2-723, 2-724.

129. See *Buchman v. Millville Mfg. Co.*, 17 F.2d 983, 985-86 (2d Cir. 1927); *Lannon Mfg. Co. v. Strauss Co.*, 235 Iowa 97, 102-06, 15 N.W.2d 899, 902-04 (1944); *J. Marshall Robbins Enterprises v. Ewald Steel Co.*, 52 Mich. App. 599, 602-03, 218 N.W.2d 125, 127-28 (1974) (plaintiff completed and raced car despite withdrawal of one of its sponsors; contract with other sponsors meant that obligation to mitigate did not require plaintiff to withdraw car from scheduled races or to leave it incomplete); *Dowling v. Whites Lumber & Supply Co.*, 170 Miss. 267, 154 So. 703 (1934):

[I]t is the settled general rule that, when the owner notifies a building contractor that the owner repudiates or renounces the contract and explicitly directs the contractor not to do anything further under it, the contractor cannot go on and complete the work and sue for the full contract price Two reasons are given as furnishing the grounds for the rule. One is that the contractor is interested only in the profit which he will make out of the contract, and, if he be given his profit in damages, he is made whole. The other is in the general principle that a person whose contract has been breached must so conduct himself as not to enhance or increase the loss or damage to the opposite party But the rule runs only so far as run the reasons which give it existence. When the work has already been entered upon and has progressed to the extent that to stop will leave a situation wherein it will be impracticable to attempt a dependable estimate of the contractor's damages to the owner, or at least will not enhance his damages, the contractor may go forward and complete the work.

Id. at 273-74, 154 So. at 705. UCC § 2-704(2) contemplates going forward with performance "in the exercise of a reasonable commercial judgment."

130. See *Hildreth v. Bergeron*, 110 N.H. 197, 199, 263 A.2d 664, 667 (1970) ("risks incident to reasonable efforts to mitigate damages are borne by the party breaking the contract whether the effort was successful or not"); *Valiga v. National Food Co.*, 58 Wis. 2d 232, 244, 206 N.W.2d 377, 384 (1973) ("[t]he test should not be whether the actions of the plaintiffs, in attempting to mitigate their damages, were right or wrong, but rather whether they were reasonable").

expectedly higher costs, she probably could hold Bob liable for the larger amount.

Problem 13 points up an apparent tension between the requirement that the aggrieved party do nothing to increase damages and the requirement that such party do everything reasonable to decrease them. Since commercially reasonable action or inaction is all that is required of the aggrieved party, the apparent tension dissolves so long as the decision made—to stop as directed or to go forward—meets the reasonableness test. The action or inaction need not be right, merely reasonable.

B. *Mitigation*

Problem 14. The Employee. On August 1, 1974, Alice and Bob entered a contract under which Bob was to work in Alice's steel fabricating plant as head of the trimming department for the 1974-75 trimming season, from September 1, 1974, through February 28, 1975, at a salary of \$3,500 a month for the six-month season. Bob was to work from 9:00 a.m. to 5:00 p.m., Monday through Friday of each week.

A week before he was to start work, Bob received a letter from Alice stating in part:

"We have decided to employ Chadd as head of the trimming department for the coming season and will not need your services."

Bob immediately consulted a lawyer who prepared a letter to Alice, over Bob's signature, stating in part:

"You have breached the contract we had and I will hold you responsible for full damages resulting from your breach."

Alice received Bob's letter two days before the season was to start and immediately responded as follows:

"Received yours of August 30 and certainly apologize. I have gotten myself into a mess. We must use Chadd as head of trimming, but I am willing to have you work for us during the season, either as Chadd's assistant or in some other capacity. Best regards to your wonderful mother."

Bob did not respond to Alice's letter.

During September and October, Bob diligently looked for work as head of the trimming department in a steel fabricating plant. He refused two job offers to head such trimming departments at \$3,000 a month, saying that he had worked hard over the years to achieve his status as a \$3,500 trimming-department head and that he was not going to move back to being a \$3,000 department head. He also rejected an offer of \$3,750 a month as an assistant to the head of the trimming

department in a third plant. Bob also was offered a job as head of the trimming department in a plant located 450 miles away from his home. Bob rejected the offer, although the salary was \$4,000 a month, because his mother was ill and he wanted to be near her.

Finally, after two months of looking, Bob made the reasonable decision that with the season one-third gone, he was unlikely to obtain work as head trimmer in the fabricated steel industry. He took a job as executive trainee in a large department store chain at a salary of \$1,500 a month, a position requiring Bob to work from 9:00 a.m. to 5:00 p.m., Monday through Friday of each week. A day or two later, Bob, who had an excellent voice, was offered a job as a singer in a local night club. He accepted the job and sang four nights a week, giving one show at 9:00 p.m. and another at 11:00 p.m. Bob held both jobs from November 1, 1974 through February 28, 1975. For that period, he earned \$6,500 per month, or a total of \$26,000—\$6,000 attributable to his job as a trainee and \$20,000 to his job as a singer. Had Alice not breached, Bob would have made \$21,000 working for her over the six-month contract term.

Bob would probably recover \$15,000 from Alice although he earned \$26,000 over the last four months of the contract term—\$5,000 more than he would have earned working for Alice for six months—and he rejected several opportunities to work in the steel fabricating industry at salaries up to and above that promised by Alice. The only earnings likely to mitigate damages would be the \$6,000 Bob earned as a trainee during the last four months of the contract period.¹³¹

Were Bob viewed solely as an economic unit, the mitigation obligation imposed on Bob might operate as a mechanism to establish the market value of the services Alice agreed to buy. Thus, had Bob obtained employment in another steel fabricating plant as head of the trimming department at a salary of \$3,500 a month for the six-month period, the contract-price (\$3,500 per month) minus market-price (\$3,500 per month) formula used in sale-of-goods cases would have yielded only nominal damages because Bob had sold his services to

131. See *Smith v. Beloit Corp.*, 40 Wis. 2d 550, 559, 162 N.W.2d 585, 589 (1968) (higher compensation at new job has no impact on wrongfully discharged employee's recovery of salary during period of unemployment following discharge). The result in *Smith* may be inconsistent with the expectancy goal of putting the aggrieved party in as good a position as if there had been no breach. Viewed from the employee's position immediately after the original contract had run, the employee who recovers the contract rate for the time of unemployment and retains the above-contract-rate wage for the balance of the period will be in a better position than if the employer had performed the contract. Only if the original contract is viewed as a series of separate weeks, months, or years, with the full salary accruing during each time period independently of other time periods, can the result in *Smith* be explained.

Alice at the market price. The contract was in balance; Alice could breach without loss.¹³² If the best price Bob could obtain for his services elsewhere was \$2,500 per month, the contract price would have been above the market price and Bob would be entitled to the \$1,000 monthly difference, just as a seller of goods would receive the benefit of a bargain to sell above market. Alice, having made an unfavorable contract, would be required to pay for her error in judgment.

The mitigation rules of the expectancy-damage system treat employees not only as economic units but as persons with feelings and obligations unrelated to the economics of the specific contract. Aggrieved employees need not humiliate themselves,¹³³ take positions of lesser status than the contract gave them,¹³⁴ or take positions in distant localities if it is personally inconvenient to do so.¹³⁵ In Problem 14, it is unlikely that Bob would be required to accept a job other than as head of trimming, or something of equal status,¹³⁶ to accept a lesser

132. See *Skehan v. Board of Trustees of Bloomsburg State College*, 358 F. Supp. 430 (M.D. Pa. 1973), *vacated and remanded on other grounds*, 501 F.2d 31 (3d Cir. 1974), *vacated and remanded*, 421 U.S. 983 (1975) (after finding that a college professor had been dismissed without a hearing, nominal damages awarded in view of the employee's failure to prove actual damages).

133. See, e.g., *University of Alaska v. Chauvin*, 521 P.2d 1234, 1240 (Alas. 1974) (a wrongfully discharged employee must accept alternative employment "if it did not involve embarrassment or hardship, in order to mitigate"), citing RESTATEMENT (SECOND) OF AGENCY § 455, Comment d (1958) (employee need not accept alternative employment if such acceptance would involve "humiliation or degradation").

134. See *Parker v. Twentieth Century-Fox Film Corp.*, 3 Cal. 3d 176, 182-84, 474 P.2d 689, 692-94, 89 Cal. Rptr. 737, 740-42 (1970); *Southern Keswick, Inc. v. Whetherholt*, 293 So. 2d 109 (Fla. Ct. App. 1974); *Hussey v. Holloway*, 217 Mass. 100, 105, 104 N.E. 471, 472-73 (1914); *Michigan Emp. Rel. Comm'n v. Kleen-O-Rama*, 60 Mich. App. 61, 64-65, 230 N.W.2d 308, 310 (1975); *Streett v. Laclede-Christy Co.*, 409 S.W.2d 691, 699-701 (Mo. 1966); *Kotan v. School District No. 110C*, 13 Ore. App. 139, 148-49, 509 P.2d 452, 457 (1973); *State ex rel. Schilling v. Baird*, 65 Wis. 2d 394, 398-400, 222 N.W.2d 666, 668-69 (1974). See also *Ballard v. El Dorado Tire Co.*, 512 F.2d 901, 905 (5th Cir. 1975), in which the employer argued that in light of the noncompetition clause in the employment contract, the employee's duty to mitigate required that he seek *any* employment and not merely similar employment. In rejecting the employer's argument, the court said that the noncompetition clause merely set up a negative duty not to compete and placed no affirmative duty on the employee to seek dissimilar employment.

135. See *Punkar v. King Plastic Corp.*, 290 So. 2d 505, 507-08 (Fla. Ct. App. 1974) ("[a] wrongfully discharged employee is not necessarily obligated to mitigate damages by accepting alternative employment at a distance from his home"); *Hussey v. Holloway*, 217 Mass. 100, 105, 104 N.E. 471, 472-73 (1914); *State ex rel. Schilling v. Baird*, 65 Wis. 2d 394, 398, 222 N.W.2d 666, 669 (1974).

136. See note 134 *supra*. See also *Schiller v. Keuffel & Esser Co.*, 21 Wis. 2d 545,

salary for doing the same work,¹³⁷ or to move to another city and leave his mother.¹³⁸ He is required to act reasonably to mitigate; but reasonableness in the context of an employment contract is not limited to economic reasonableness. In recognizing status consciousness as a factor in determining whether Bob acted reasonably, the system recognizes to some extent human irrationality and psychological needs.

Although Bob probably was not obligated to accept the position as a trainee, he did so and the \$6,000 he earned would be applied to mitigate damages.¹³⁹ Since Bob could not find employment as head of a trimming operation in the steel fabricating industry, the market value of his services in this specialized capacity was zero. Under a strict contract-price-market-price analysis, money earned in another capacity might be irrelevant in ascertaining damages. He contracted to sell his services for \$3,500 a month when the market price for such services was zero. Just as in Problem 13, however, when the \$25 salvage value of the partially completed chair was deducted from the aggrieved party's recovery, the "salvage or scrap" value of Bob's services should be deducted, at least to the extent Bob realized that value. Although Bob had no obligation to sell his services in an inferior position, the income obtained when he chose to do so would go in mitigation.

The money earned as a trainee is distinguishable from Bob's income as a singer. Bob sold Alice his time from 9:00 a.m. to 5:00 p.m., Monday through Friday of each week, for a six-month period. Bob could not have worked as a trainee during these hours had Alice not breached. Alice's breach, however, was not a prerequisite to Bob being able to accept a position as a singer. He could have fulfilled his obligations to Alice under the employment contract while still singing

553, 124 N.W.2d 646, 651 (1963), in which the court said that a wrongfully discharged employee need not look for nor accept employment of a "different or inferior kind in order to minimize damages."

137. See *Streett v. Laclede-Christy Co.*, 409 S.W.2d 691, 701 (Mo. 1966).

138. See note 135 *supra*.

139. See *Southern Kewick, Inc. v. Whetherholt*, 293 So. 2d 109 (Fla. Ct. App. 1974) (reversible error to charge the jury that damages were not to be reduced by wrongfully discharged employee's subsequent employment of a different or inferior nature; while the employee need not seek inferior or different employment, if such employment is obtained the earnings go in mitigation). See also *Sheppard v. Southern Ry.*, 258 F. Supp. 217, 223 (E.D.N.C. 1966), *aff'd sub nom. Edwards v. Southern Ry.*, 376 F.2d 665 (4th Cir. 1967) (employee's earnings at a lesser position went in mitigation of damages); *Carroll v. Civil Serv. Comm'n*, 31 Cal. App. 3d 562, 566-67, 107 Cal. Rptr. 557, 558-59 (1973) (\$29.40 earned by a wrongfully discharged civil service employee while spending 147 days in jail mitigated the damages owed by the employer).

in a night club four evenings a week, unless his contract with Alice prohibited such work. Since Alice's breach did not make the singing income possible, the original contract and the singing were completely unrelated and the income Bob earned singing would not go in mitigation.¹⁴⁰ Bob always had the ability to do both jobs. Had Bob accepted a job on a shift running from 6:00 p.m. to 6:00 a.m., Monday through Friday, the earnings—or most of them—would have gone in mitigation even though the hours did not overlap.¹⁴¹ Because Bob could not have worked a 12-hour shift for another employer while carrying out his 9:00 a.m. to 5:00 p.m. obligation to Alice, her breach would have made it possible for Bob to take the second job.

In the context of the expectancy damage system, employers who breach employment contracts and buyers who breach sales contracts are treated similarly. In both cases, damage awards are based on the difference between the contract price and the market price. In employment contracts, damage awards are established only after taking

140. See *Redman v. Department of Educ.*, 519 P.2d 760, 771 (Alas. 1974) (only the income from a position discharged teacher could not have held had she been teaching would go in mitigation); *Albert Johann & Sons Co. v. Echols*, 143 Ind. App. 122, 130, 238 N.E.2d 685, 689 (1968) (“[t]he question . . . is . . . what income was received as a result of being relieved from performance of the litigated contract”); *Polk v. Torrence*, 218 Tenn. 680, 405 S.W.2d 575 (1966) (after dismissal, plaintiff increased his hours on a second job by working Saturdays and Sundays; increase in pay did not go in mitigation because it could have been earned without regard to the original job). See also *Lee v. Ralston School Dist.*, 180 Neb. 784, 145 N.W.2d 919 (1966) (discharged teacher could not have worked for the Navy while performing his school duties, thus, income from new job as Navy recruiter was deducted from damages). In *Currieri v. City of Roseville*, 50 Cal. App. 3d 499, 123 Cal. Rptr. 314 (1975), a wrongfully-discharged policeman, rather than seeking other employment, enrolled as a full-time student and was found by the trial court to have formed an intention to pursue a scholastic career. In response to the employee's argument that he had no duty to seek other employment and that the mitigation rule merely provided for “a deduction of the amount he might have earned had he continued to seek employment,” the court on appeal quoted from the trial court's finding “that had this plaintiff been reinstated . . . he would have resigned to continue school.” *Id.* at 506-07, 123 Cal. Rptr. at 318-19. In view of the employee's intention to remain a student, the court denied recovery of wages for the period following the formation of the fixed intention to become a student.

141. See note 140 *supra*. In *State ex rel. Klingler v. Baird*, 56 Wis. 2d 460, 468-69, 202 N.W.2d 31, 36 (1972), the court said:

In determining the difference between full back pay and earnings from other employment, two factors should be given mutual consideration. First, whether such earnings accrued during what would have been his regularly assigned hours of duty, and second, the amount of his earnings, if any, which he was receiving outside his regularly assigned hours of duty, immediately preceding his suspension.

into account the personal needs of the employee, but the effort remains one to establish the market price¹⁴² of the services. In sales contracts, however, market price is established without regard to the seller's personal problems unless these problems are known to the buyer at the time the contract is made. One possible reason for the different treatment is that the foreseeability test controls in both instances. Employers know at the time of contracting that employees may have personal problems which will affect their ability to mitigate damages caused by a breach. Such problems are normal to employment contracts. Personal problems normally do not dominate contracts to sell goods. Only when special circumstances are known to the seller at the time of contracting is the seller liable for anything but pure contract-price-market-price damages.¹⁴³ If special circumstances are present, damages over and above market price damages may be awarded,¹⁴⁴ but a condition precedent to such special damages is proof that the buyer has taken reasonable steps to mitigate.¹⁴⁵

Problem 15. The Layabout. Same fact pattern as in Problem 14: repudiation by Alice, the employer, of a contract for a six-month season running from September 1, 1974 through February 28, 1975; \$3,500 monthly salary as head of the trimming department; repudiation shortly before September 1, 1974; except that Bob, the employee, failed to seek other employment and none was offered. On March 15, 1975, Bob filed suit for breach of contract. At trial, the evidence was clear that had Bob sought employment in a capacity similar to that of head of the trimming department, he would have been unsuccessful. Would Bob be able to recover \$3,500 per month for the full six-month period?

142. One may view the mitigation doctrine in employment cases as a mechanism to establish the market price for the services the employee contracts to sell. If no other similar position is available to the employee, the market price for that kind of service is zero and a damage award of the contract price is the same as a contract-price-minus-market price award. If mitigation is solely a mechanism for establishing the market price for the kind of service sold, it seems to be error to deduct money earned in an inferior position when no comparable position can be found. Whatever is earned in the inferior position, the market price of the comparable position remains zero. Courts do not discuss mitigation in employment cases as a mechanism for establishing market price, however, and if the overall expectancy goal of putting the injured party in as good a position governs, money earned in inferior positions should go in mitigation.

143. See UNIFORM COMMERCIAL CODE § 2-715(2); see also *KLPR TV, Inc. v. Visual Electronics Corp.*, 465 F.2d 1382, 1388 (8th Cir. 1972) (lessee of TV equipment persisted in using defective equipment beyond a reasonable period of time); *Valiga v. National Food Co.*, 58 Wis. 2d 232, 244-45, 206 N.W.2d 377, 384 (1973) ("[t]he test should not be whether the actions of the plaintiffs, in attempting to mitigate their damages, were right or wrong, but rather whether they were reasonable").

144. See note 143 *supra*.

145. *Id.*

Despite the fact that the mitigation rule in its usual form requires that the aggrieved party use reasonable efforts to reduce damages,¹⁴⁶ Bob, who made no effort to mitigate, nevertheless would recover the full \$21,000 contract price. Whether or not he acted reasonably in failing to look for other employment, no similar employment was available. Had he used reasonable efforts, he would have failed. The evidence therefore established that the market value of Bob's service as head of the trimming department was zero. Consequently, Alice would have no legitimate complaint about Bob's inaction. It might be said that Bob acted reasonably although he did not realize it at the time. Whether his actions were reasonable or not, the lack of availability of comparable employment would be the controlling factor and Bob could recover. Thus, a caveat must be added to the rule that the aggrieved party must make all reasonable efforts to reduce the damages: He either must make such efforts, or prove that such efforts, if made, would have failed.¹⁴⁷

Problem 16. The Entrepreneur. Alice, a plumbing contractor employing 50 plumbers, entered a contract with Bob, a general contractor, to do the plumbing work on a large building Bob was constructing.

146. See *C.J. Langenfelder & Sons, Inc. v. United States*, 384 F.2d 1005, 1006-07 (Ct. Cl. 1967) (no duty to take impractical and uneconomic steps to turn unsuitable soil into useful material); *Sackett v. Spindler*, 248 Cal. App. 2d 220, 238-39, 56 Cal. Rptr. 435, 447 (1967) (no duty to seek new purchasers after buyer's default; almost impossible to sell newspaper after publicized sale to defendant had fallen through); *Steele v. J.I. Case Co.*, 197 Kan. 554, 564-65, 419 P.2d 902, 911 (1966) (buyer not barred from recovering his damages, if, relying on the seller's promises, he fails to take steps to lessen his loss); *Whitley County Bd. of Educ. v. Meadors*, 444 S.W.2d 890, 891-92 (Ky. 1969) (discharged teacher relying on superintendent's assurance she would be reemployed); *Streett v. Laclede-Christy Co.*, 409 S.W.2d 691, 701 (Mo. 1966) ("[t]he question is whether plaintiff had used reasonable diligence and had done the best that he could under prevalent mercantile conditions and opportunities"); *Little v. Rose*, 285 N.C. 724, 728, 208 S.E.2d 666, 669 (1974) (duty to mitigate is "established principle," unmitigated damages considered too remote for recovery); *Schafer v. Sunset Packing Co.*, 256 Ore. 539, 542, 474 P.2d 529, 530 (1970) ("party injured by a breach of contract is required to do what reasonable care and business prudence would dictate in order to minimize his loss"); *Ivester v. Family Pools, Inc., Bosco Indus.*, 262 S.C. 67, 70, 202 S.E.2d 362, 363 (1974) (buyer not required to make arrangement to have pool completed by another contractor; the seller will not "be heard to say that the plaintiff [buyer] might have performed for him"); *Birge v. Toppers Menswear, Inc.*, 473 S.W.2d 79, 86 (Tex. Civ. App. 1971, writ ref'd n.r.e.) (in landlord's breach of covenant to repair, tenant owes a duty to move its business to another location).

147. See *Zuider Zee Oyster Bar, Inc. v. Martin*, 503 S.W.2d 292, 297 (Tex. Civ. App. 1973, writ ref'd n.r.e.) (allegation that wrongfully discharged employee purposely refrained from seeking employment). See also *School Employee Ass'n v. Personnel Comm'n*, 30 Cal. App. 3d 241, 249-50, 106 Cal. Rptr. 283, 288-89 (1973).

The contract called for a payment of \$120,000 for the plumbing work and Alice calculated that her cost would be \$100,000. When the plumbing work was 75% completed, Alice having spent \$75,000 on the job, Bob had an argument with Clara, president of the corporation that employed him. As a result, Bob withdrew his work crews and directed Alice to do the same. Alice did as she was directed. Within a few days, Bob repudiated his contract with the corporation.

On behalf of the corporation, Clara asked Alice if she would complete the plumbing work on the building, the same work Alice was to do under her contract with Bob. Alice agreed to complete the job for \$40,000. Clara agreed to this price and Alice finished the work, spending \$25,000 and receiving \$40,000 from the corporation.

In a suit for breach of contract against Bob, would the \$15,000 profit Alice made on the second contract mitigate the \$95,000 damage award to which Alice would otherwise be entitled?

Alice probably would recover \$95,000 from Bob; the \$15,000 profit on the second contract for the same work would not go in mitigation.¹⁴⁸ With a \$95,000 recovery, Alice would make a \$20,000 profit on her contract with Bob. Since Alice also retained the \$15,000 profit she made in her contract with the corporation, her position would be better than if Bob had not repudiated. Nonetheless, the mitigation doctrine would not set off the profits on the second contract against the amount Bob owed.

Alice, the plumbing contractor, is in a different position than Bob, the employee in Problem 14. In theory and in fact, Alice, who performs her contracts by means of employees, can contract for and perform more than one job in the same period of time.¹⁴⁹ By using crews of employees, Alice can do several jobs simultaneously in several different locations. The employee cannot. Only the employer's breach in Problem 14 allowed Bob to take on a traineeship. Just as the employer's breach in Problem 14 did not make it possible for Bob to accept employment as a night-club singer, so Bob's breach of the plumbing contract is unrelated to Alice's ability to take on other work. Since

148. See *Olds v. Mapes-Reeve Constr. Co.*, 177 Mass. 41, 58 N.E. 478 (1900). See also *Grinnell Co. v. Voorhees*, 1 F.2d 693, 694-95 (3d Cir.), cert. denied, 266 U.S. 629 (1924); *Willred Co. v. Westmoreland Metal Mfg. Co.*, 200 F. Supp. 59, 62-63 (E.D. Pa. 1961); *Katz v. Exclusive Auto Leasing, Inc.*, 282 A.2d 866, 868 (Del. Super. Ct. 1971); *M. & R. Contractors & Builders, Inc. v. Michael*, 215 Md. 340, 354-55, 138 A.2d 350, 358 (1958).

149. See Patterson, *Builder's Measure of Recovery for Breach of Contract*, 31 COLUM. L. REV. 1286, 1306-07 (1931).

Bob's breach does not create in Alice the power to assume other contractual duties, Alice's activities on other jobs are unrelated to Bob's breach, and profits on other jobs do not go in mitigation.

In Problem 16, however, the contract Alice made with Clara could not have been made except for the fact that Bob breached. Does this fact convert Alice, the plumbing contractor, into a factual counterpart of Bob, the employee who accepted a trainee's job from 9:00 a.m. to 5:00 p.m., or does her second contract remain independent of the breach of the first?

On facts similar to those in Problem 16, courts have denied Bob the right to have the profits on the second contract applied to mitigate the damages he must pay.¹⁵⁰ There are at least two arguments in support of this denial. First, since a contractor has a general capacity to assume additional jobs, it is unimportant that the particular job taken is available only because of the breach. At the time of contracting, Bob knew of Alice's capacity to perform more than a single contract. Bob, thus, had reason to know that if he breached, profits on other jobs being done by Alice would not go in mitigation. Since he had no reason to expect mitigation, he now has no reason to complain when profits on the second contract do not go in mitigation.¹⁵¹

The second argument rests on the risk of loss associated with agreements to accomplish a specific result for a set price. In both contracts, Alice agreed to do a specific job for a specific price: \$120,000 in the contract with Bob and \$40,000 in the contract with Clara. If Alice's costs on either of the contracts exceeded the contract price, Alice would be required to absorb the loss. Since Alice risked such a loss in her contract with Clara, a loss for which Bob would not be liable, it is arguable that Bob should not benefit from profits on the second contract.¹⁵²

150. See note 148 *supra*.

151. The argument applies the *Hadley* doctrine to limit the mitigation doctrine.

152. See *Olds v. Mapes-Reeve Constr. Co.*, 177 Mass. 41, 58 N.E. 478 (1900) (Plaintiff subcontractors contracted with the owner to complete the job plaintiffs had started under a contract with the breaching contractor. The court rejected the general contractor's argument that plaintiffs' profits on the contract with the owner should go in mitigation, saying:

If the contract [with the owner] had resulted in a loss to them [plaintiffs], they could not have charged the defendant with the loss, to the increase of their damages. As the contract resulted in a gain to them, there is no reason why the defendant should receive this gain in diminution of the damages for which it was liable.

Id. at 4, 58 N.E. at 479.

Alice assumed the entire risk in both contracts and, thus, is presumably entitled to all of the benefits.

The risk-of-loss argument does not address the essence of the problem. If the mitigation doctrine dictates that reasonable actions by Alice to reduce damages include contracting to complete the same work, Bob should be liable for any losses sustained in this reasonable attempt to mitigate. The party who breaches properly bears the cost of reasonable, though unsuccessful, efforts to mitigate.¹⁵³ Bob should bear the risk of loss if he reasonably should have foreseen such mitigating action.¹⁵⁴ Because Alice could take on other work while performing her contract with Bob, however, it is unlikely that he would foresee that Alice's post-breach activities would go in mitigation at all. He would foresee neither loss nor gain as a result of Alice's postbreach activities. If the profit on Alice's second contract were to go in mitigation, Bob would receive an unforeseen windfall.

Mitigation reduces liability—makes breach less costly—while leaving the aggrieved party in as good a position as if there had been no breach. While the aggrieved party in every contract has the duty to mitigate,¹⁵⁵ the duty operates differently in different circumstances. "Cover" activities in sales contracts usually do not reduce liability except to the extent that consequential damages are involved. Aggrieved buyers and sellers have the option of recovering the difference between market and contract prices if it is larger than the difference between cover and contract prices.¹⁵⁶ If the aggrieved buyer or seller of goods has a free option, cover becomes a mitigating duty only when consequential damages are sought.¹⁵⁷ In building contracts and similar situations, post-breach activities of entrepreneurs who can perform more than a single contract at the same time do not go in mitigation. In

153. See *Duffy v. Woodcrest Builders, Inc.*, 2 Conn. Cir. Ct. 137, 139-49, 196 A.2d 606, 608-10 (1963); *Katz v. Exclusive Auto Leasing, Inc.*, 282 A.2d 866, 868 (Del. Super. Ct. 1971); *Hendrickson-McCabe Constr. Co. v. State*, 120 Misc. 818, 822, 199 N.Y.S. 668, 671 (Ct. Cl. 1923). See also *Tampa Elec. Co. v. Nashville Coal Co.*, 214 F. Supp. 647, 652 (M.D. Tenn. 1963), citing RESTATEMENT OF CONTRACTS § 336(2) (1932).

154. See *Tampa Elec. Co. v. Nashville Coal Co.*, 214 F. Supp. 647, 653 (M.D. Tenn. 1963); note 151 *supra* and accompanying text.

155. See note 117 *supra*.

156. See notes 47-48, 103 *supra*.

157. Under the UCC only the buyer is entitled to consequential damages. See note 105 *supra*; see also *Neal-Cooper Grain Co. v. Texas Gulf Sulphur Co.*, 508 F.2d 283, 294 (7th Cir. 1974).

employment contracts, the breaching employer consistently benefits from the mitigation doctrine, thus encountering less pressure from the legal system to perform. Other pressures may encourage performance, of course. Concern for employee morale or personal relationships tend to inhibit employer action. The mitigation doctrine in employment contracts most often is significant when dealing with professional and executive personnel, who are more likely to be employed under term contracts than as employees at will. Union pressure is more important at lower employment levels than contract restraints. The growth of unionization at the professional level,¹⁵⁸ however, or the fear of its growth, may inhibit employers from breaching employment contracts. Whatever other pressures may exist, the expectancy damage system itself rarely encourages employers to perform.

V. SPECIAL PROBLEMS

A. *Windfall Damages*

Except when the prospect of consequential damages discourages breach, the expectancy damages system rarely encourages performance except by those who made favorable contracts and who might be expected to perform in the absence of pressure from the legal system. The system otherwise tends to neutrality as regards performance or breach. In some cases, however, the system strongly encourages breach.

Problem 17. Sand and Gravel. Alice, a large-scale vendor of sand and gravel to the construction industry, and Bob, the owner of a large tract of land, entered a written contract under which Alice received a five-year right to remove all sand and gravel she wished to remove from Bob's tract, with the limitation that she could take no more than would leave the tract level with the land surrounding it. Alice agreed that, if within the five-year period she failed to remove sufficient sand and gravel to level Bob's tract, she would, at her expense, level the land in relationship to the land around it. Alice agreed to pay \$250,000 in return for the five-year right.

Over the five-year period, Alice took all of the sand and gravel she needed. She refused Bob's demand that she level the land. Bob filed suit and at trial it was stipulated that it would cost \$175,000 to level the lot, that the land in its unlevelled state was worth \$90,000, and that leveled, the land would be worth \$100,000. How much should Bob recover?

158. For example, among faculty members, see BUREAU OF NATIONAL AFFAIRS, FACULTY ORGANIZING: SPECIAL REPORT (1976); FACULTY BARGAINING IN THE SEVENTIES App. A (T. Tice ed. 1973).

Under the usual expectancy damage analysis, Bob would recover \$10,000, the difference between the value of what he would have owned had Alice performed (a leveled lot worth \$100,000) and the value of what he did own as the result of her breach (an unlevelled lot worth \$90,000).¹⁵⁹ With such an award, Bob would be in as good a dollar position as if Alice had performed.

If the damages were limited to \$10,000, however, Alice would receive the sand and gravel for \$165,000 less than she promised to pay. Alice's expected costs were \$250,000 plus the cost of leveling the tract of land. A \$10,000 award would permit Alice to receive the sand and gravel for \$260,000, rather than the \$425,000 she promised to pay. The economic pressures imposed by the legal system would encourage—almost demand—breach of the contract. In view of the profitable nature of the breach, Alice would be penalized by performance and rewarded by breach. Should the system penalize performance and reward breach?¹⁶⁰

Spending \$175,000 to level the tract and thereby increase its value by \$10,000 would make no economic sense. But Bob did not seek a leveled tract; he sought a court order directing Alice to pay the promised amount for the sand and gravel, leaving him to decide how the \$175,000 should be spent. There might or might not be economic waste depending on how Bob spent the money. If Bob's recovery were limited to \$10,000, Alice could determine how the \$165,000 balance would be. If Alice were required to pay Bob the full \$175,000 price, the spending decision would be Bob's. The economic waste that

159. See *Peevyhouse v. Garland Coal & Mining Co.*, 382 P.2d 109 (Okla. 1963).

160. In *Groves v. John Wunder Co.*, 205 Minn. 163, 286 N.W. 235 (1939), with facts similar to those of Problem 17, a divided court held plaintiff entitled to recover the cost of leveling the lot although the difference in value between the leveled and unlevelled land was small. As far as I have been able to ascertain, no court has followed the lead of the *Groves* case. See *Peevyhouse v. Garland Coal and Mining Co.*, 382 P.2d 109 (Okla. 1963). In *H.P. Droher & Sons v. Toushin*, 250 Minn. 490, 498, 85 N.W.2d 273, 279 (1957), the Minnesota supreme court described the *Groves* case as decided "by a divided court, three members of the court concurring in the opinion, two dissenting, and two . . . [taking] no part" and indicated that the majority opinion in *Groves* was "based, at least in part, on the fact that the breach of the contract was wilful and in bad faith." For a similar characterization of *Groves* as based on the "wilful or intentional" nature of the breach, see *Hutson v. Chambless*, 157 Tex. 193, 199, 300 S.W.2d 943, 946 (1957). Cf. *P.G. Lake, Inc. v. Sheffield*, 438 S.W.2d 952 (Tex. Civ. App. 1969, writ ref'd n.r.e.) (affirming an award of the cost of restoring the surface of the land after the drilling of a dry oil well, but expressing a preference for the value differential rule of *Peevyhouse*. The party who breached failed to prove the value differential in this case.)

might stem from specific performance of the promise to level the hill is not directly involved. The question is simply which of two parties should decide how the \$175,000 would be spent.

If Bob's recovery were limited to \$10,000, Alice would profit substantially from her breach. But an award of more than \$10,000 would constitute a windfall to Bob; his dollar position would be better than if Alice had performed. As between the two, who should get the windfall—Alice, who would profit from her breach, or Bob, who performed as promised? While one might argue for a damage system that neither encourages nor discourages performance, it is difficult to advance a reasoned argument in favor of a damage system that affirmatively encourages nonperformance. If the choice is between a \$10,000 or a \$175,000 award, the better choice would seem to be the larger amount.

A statute establishing a state fund to receive windfall damages of the kind generated in Problem 17 would remedy a part of the difficulty. Under such legislation, Bob would receive \$10,000, an amount sufficient to elevate him to his expected dollar position¹⁶¹ had Alice performed, and the fund would receive the remaining \$165,000. To avert injury to Bob any such legislation should also award him court costs and lawyers' fees. With such legislation, Alice would not be encouraged to breach by visions of a reward for her failure to perform. In the absence of such a statutory fund, however, it seems preferable to turn the windfall over to the aggrieved party rather than to permit the breaching party to retain it.

The proposed statutory solution might encourage economic waste. Alice, faced with a \$175,000 expenditure in any event, is just as likely to spend the money leveling the hill as she is to pay the same amount in damages. To avoid being neutral about spending \$175,000 to achieve a \$10,000 increase in value, any legislative solution should probably allow Alice to retain at least a small portion of the windfall—perhaps ten percent—despite the fact that she would be encouraged to breach.

B. *Liquidated Damages*

Subject to some judicially created limitations, the parties may stipulate in the contract the damages payable on breach. The traditional

161. While Bob's dollar position would be the same, he would not obtain what was promised—a leveled lot—nor would he obtain the wherewithal to pay for what was promised,

treatment of liquidated damages is described in the following passage from an 1888 Alabama case:

1. The court will always seek to ascertain the *true and real intention* of the contracting parties, giving due weight to the language or words used in the contract, but not always being absolutely controlled by them, when the enforcement of such contract operates with unconscionable hardship, or otherwise works an injustice.

2. The mere denomination of the sum to be paid, as "liquidated damages," or as "a penalty," is not conclusive on the court as to its real character. Although designated as "liquidated damages," it may be construed as a penalty; and often, when called a "penalty," it may be held to be liquidated damages, where the intention to the contrary is plain.

3. The courts are disposed to lean against any interpretation of a contract which will make it liquidated damages; and in all cases of doubtful intention, will pronounce the stipulated sum a penalty.

4. Where the payment of a smaller sum is secured by an obligation to pay a larger sum, it will be held a penalty, and not liquidated damages.

5. Where the agreement is for the performance or nonperformance of a single act, or of several acts, or of several things which are but minor parts of a single complex act, and the precise damage resulting from the violation of each covenant is wholly uncertain, or incapable of being ascertained save by conjecture, the parties may agree on a fixed sum as liquidated damages, and the courts will so construe it, unless it is clear, on other grounds, that a penalty was really intended.

6. When the contract provides for the performance of several acts of different degrees of importance, and the damages resulting from the violation of some, although not all of the provisions, are of easy ascertainment, and one large gross sum is stipulated to be paid for the breach of any, it [the sum] will be construed a penalty, and not as liquidated damages.

7. When the agreement provides for the performance of one or more acts, and the stipulation is to pay the same gross sum for a *partial* as for a total or complete breach of performance, the sum will be construed to be a penalty.

8. Whether the sum agreed to be paid is out of proportion to the actual damages, which will probably be sustained by a breach, is a fact into which the court will not enter on inquiry, if the intent is otherwise made clear, that liquidated damages and not a penalty is in contemplation.

9. Where the agreement is in the alternative, to do one of two acts, but is to pay a larger sum of money in the one event than in the other,

the obligor having his election to do either, the amount thus agreed to be paid will be held liquidated damages, and not a penalty.

10. In applying these rules, the controlling purpose of which is to ascertain the real intention of the parties, the court will consider the nature of the contract, the terms of the whole instrument, the consequences naturally resulting from a breach of its stipulations, and the peculiar circumstances surrounding the transaction; thus permitting each case to stand, as far as possible, on its own merits and peculiarities.

These rules are believed to be sustained by the preponderance of judicial decision¹⁶²

The rules set forth reflect the traditional judicial hostility to liquidated damages. When in doubt, courts will invalidate the clause.¹⁶³ The rules also show the strength of the expectancy concept; stipulated damages larger than expectancy are not enforceable because they are penal.¹⁶⁴ While the traditional hostility of the courts towards liquidated damage clauses has softened somewhat over the years,¹⁶⁵ the sum stipulated is still tested against the sum the expectancy rules would yield.¹⁶⁶

The judicial treatment of liquidated damage clauses varies among jurisdictions, some holding the amount stipulated need only be a

162. *Keeble v. Keeble*, 85 Ala. 552, 555-57, 5 So. 149, 150-51 (1888).

163. *Farthing v. San Mateo Clinic*, 143 Cal. App. 2d 385, 392, 299 P.2d 977, 981-82 (1956) ("[t]he law does not favor either contracts in restraint of trade or agreements for liquidated damages"); *Hyman v. Cohen*, 73 So. 2d 393, 402 (Fla. 1954) (*dicta*); *Donow v. Board of Trustees of S. Ill. Univ.*, 21 Ill. App. 3d 139, 148-49, 314 N.E.2d 704, 711 (1974) ("[i]f the exact nature [of a clause assessing parlaying fines against teachers' salaries] is doubtful it is the trend to consider it as a penalty"); *City of N.Y. v. Brooklyn & Man. Ferry Co.*, 238 N.Y. 52, 56, 143 N.E. 788, 790 (1924); *Testerman v. Home Beneficial Life Ins. Co.*, 524 S.W.2d 664, 668 (Tenn. Ct. App. 1974).

164. *See Bricklayers Local 21 v. Thorleif Larsen & Son, Inc.*, 519 F.2d 331, 333-34 (7th Cir. 1975); *Ogden Dev. Corp. v. Federal Ins. Co.*, 508 F.2d 583, 586-87 (2d Cir. 1974); *Traylor v. Grafton*, 273 Md. 649, 662-68, 332 A.2d 651, 660-64 (1975); *Bowbells Public School Dist. No. 14 v. Walker*, 231 N.W.2d 173, 177 (N.D. 1975); *S.L. Rowland Constr. Co. v. Beall Pipe & Tank Corp.*, 14 Wash. App. 297, 540 P.2d 912 (1975).

165. *See Priebe & Sons, Inc. v. United States*, 332 U.S. 407, 411-12 (1947); *Southwest Eng'r Co. v. United States*, 341 F.2d 998, 1001 (8th Cir.), *cert. denied*, 382 U.S. 819 (1965) ("courts presently . . . do not look with disfavor upon liquidated damage stipulations"); *D.H.M. Industries, Inc. v. Central Port Warehouse, Inc.*, 127 N.J. Super. 499, 503, 318 A.2d 20, 23 (Super. Ct. App. Div. 1973), *aff'd*, 64 N.J. 548, 318 A.2d 19 (1974) ("[t]he modern tendency of the courts [is to find] liquidated damage clauses rather than penalties"); *Goργο Constr. Co. v. Stein*, 256 Minn. 476, 481, 99 N.W.2d 69, 74 (1959) ("[t]he modern trend is to look with candor, if not with favor, upon a contract provision for liquidated damages").

166. *See note 164 supra*.

reasonable forecast on the facts known at the time of contracting¹⁶⁷ and others that it must be reasonable when viewed with hindsight after the contract is breached.¹⁶⁸ The cases can be summarized as follows: If at the time a contract is made the parties include a clause fixing damages in the event of a breach, the clause will be sustained if the harm caused by the breach is difficult to ascertain and the amount set by the parties is a reasonable forecast of the expectancy damages a court would award absent such a clause. It is unclear whether the damages must be difficult to ascertain at the time the contract is made, at the time of the breach, or at both times. It is unclear whether a

167. Many cases say that the test of the parties' intention, or the reasonableness of the parties' forecast, requires only that the court examine the situation when the contract was made, without regard to the damages actually suffered. See *Bricklayers Local 21 v. Thorleif Larsen & Son, Inc.*, 519 F.2d 331, 333 (7th Cir. 1975); *Walter E. Heller & Co. v. American Flyers Airline Corp.*, 459 F.2d 896, 898-99 (2d Cir. 1972); *Traylor v. Grafton*, 273 Md. 649, 668, 332 A.2d 651, 663 (1975).

168. In *Hutchison v. Tompkins*, 259 So. 2d 129 (Fla. 1972), the court held that:

The better result . . . is to allow the liquidated damage clause to stand if the damages are not readily ascertainable at the time the contract is drawn, but to permit equity to relieve against the forfeiture if it appears unconscionable in light of the circumstances existing at the time of breach.

Id. at 132. The court hypothesized as an appropriate case for equitable intervention one in which a \$100,000 liquidated damage clause was contained in a contract for the sale of land; at the time of contracting the clause was reasonable; and after vendee's breach, the vendor resold the land for \$2,000 under the original contract price. A somewhat different approach was seen in *Norwalk Door Closer Co. v. Eagle Lock & Screw Co.*, 153 Conn. 681, 220 A.2d 263 (1966):

The circumstances which the parties might reasonably foresee at the time of making a contract could, in any given case, be vastly different from the circumstances which actually exist when a court is called upon to enforce the contract. It is not the function of the court to determine by hindsight the reasonableness of the expectation of the parties at the time the contract was made, but it is the function of the court at the time of enforcement to do justice. In the ordinary contract action the court determines the just damages from evidence offered. In a valid contract for liquidated damages, the parties are permitted, in order to avoid the uncertainties and time-consuming effort involved, to estimate in advance the reasonably probable foreseeable damages which would arise in the event of a default. Implicit in the transaction is the premise that the sum agreed upon will be within the fair range of those just damages which would be called for and provable had the parties resorted to proof. Consequently, if the damage envisioned by the parties never occurs, the whole premise for their agreed estimate vanishes, and, even if the contract was to be construed as one for liquidated damages rather than one for a penalty, neither justice nor the intent of the parties is served by enforcement. To enforce it would amount in reality to the infliction of a penalty.

Id. at 689-90, 220 A.2d at 268. See also *Wright v. Schutt Constr. Co.*, 262 Ore. 619, 624-26, 500 P.2d 1045, 1047-48 (1972). Cf. UNIFORM COMMERCIAL CODE § 2-718(1) (damage may be liquidated, "but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach . . .").

forecast reasonable at the time the contract is made will be sustained if the damages actually suffered are much smaller or much larger than the amount forecast.¹⁶⁹

Problem 18. The Account Executive. Alice and Bob entered a written employment contract under which Alice was to work for Bob for two years for a salary of \$15,000 for the first year and \$20,000 for the second year. Bob operated an advertising agency and Alice was employed as a junior account executive. Under the contract, Alice agreed to abide by rules and regulations governing all agency employees. The contract provided that if either Alice or Bob failed to fulfill the agreement "or any part thereof, or any stipulation therein contained, such party agrees to pay the other the sum of \$5,000, the amount being viewed by the parties as liquidated damages and not a penalty." Alice breached the contract by refusing to continue working after the first three months. In a suit by Bob against Alice, would Bob be able to enforce the "liquidated damage" clause?

Although Bob could recover expectancy damages if it would cost him more to replace Alice for the 21 months remaining on the contract than he had promised to pay her over that period,¹⁷⁰ it is doubtful that he could waive actual damages and collect \$5,000 under the liquidated damage clause even if he could demonstrate that the actual damages were approximately \$5,000. The \$5,000 clause applied both to major and minor breaches of rules and regulations. Applied to minor breaches—coming to work five minutes late, or quitting a week before termination—the \$5,000 would be deemed a penalty. Even if the actual breach were major, as it was, many courts would refuse to enforce the clause because it could have been applied to a minor breach.¹⁷¹ In employment contract cases, the courts' reluctance to validate large liquidated damage clauses may be explained by the fact that the threat of large and certain damages discourages employees from electing to pay damages in lieu of performing and smacks of involuntary servitude. (Similar reasoning supports the common refusal of courts to direct that an employee specifically perform the employment

169. See notes 162-68 *supra*.

170. See, e.g., *Roth v. Speck*, 126 A.2d 153, 155 (D.C. Ct. App. 1956).

171. See *Webster v. Garrette*, 10 Cal. App. 2d 610, 615, 52 P.2d 550, 552 (1935); *Oldis v. Grosse-Rhode*, 35 Colo. App. 46, 51-52, 528 P.2d 944, 947 (1974); *McMurray v. Faust*, 224 Iowa 50, 58-59, 276 N.W. 95, 100 (1937); *Wilt v. Waterfield*, 273 S.W.2d 290, 295-96 (Mo. 1954). Cf. *Connelly v. Zee*, 366 F. Supp. 1229, 1231-32 (D.V.I. 1973) (liquidated damage clause rescued from usual rule because "the parties had in mind only such serious defaults as would probably result in termination of the lease").

contract.)¹⁷²

Most litigation over liquidated damages involves allegations that the amount stipulated is larger than an expectancy analysis would yield and thus amounts to a penalty. The theory seems to be that the law abhors a penalty,¹⁷³ and any damage much above expectancy amounts to a penalty.¹⁷⁴ Pressuring performance by stipulating a damage figure substantially above the expectancy level is often considered a violation of public policy, even when the parties occupy equal bargaining positions.¹⁷⁵ In a system designed to minimize government inter-

172. See *Nassau Sports v. Peters*, 352 F. Supp. 870, 875-76 (E.D.N.Y. 1972).

173. A "penalty" is described in *Garrett v. Coast & S. Fed. Sav. & Loan Ass'n*, 9 Cal. 3d 731, 511 P.2d 1197, 108 Cal. Rptr. 845 (1973), as a provision which operates to compel performance of an act . . . and usually becomes effective only in the event of default . . . upon which a forfeiture is compelled without regard to the actual damages sustained by the party aggrieved by the breach The characteristic feature of a penalty is its lack of proportional relation to the damages which may actually flow from failure to perform under a contract.

Id. at 739, 511 P.2d at 1202, 108 Cal. Rptr. at 850. See *Skendzel v. Marshall*, 261 Ind. 226, 231, 301 N.E.2d 641, 644 (1973), *cert. denied*, 415 U.S. 921 (1974).

174. The courts, of course, do not insist that the amount of damages established in the contract be identical with the expectancy damages which are reasonably foreseeable or suffered. They inquire whether the sum stipulated is "grossly disproportionate" to the damages actually sustained. See, e.g., *Walker v. Rocky Mountain Rec. Corp.*, 29 Utah 2d 274, 280, 508 P.2d 538, 542 (1973). In *Wright v. Schutt Constr. Co.*, 262 Ore. 619, 500 P.2d 1045 (1972), the court said it would not invalidate a liquidated damage because of the amount listed unless that amount "is 'grossly disproportionate,' or has no 'reasonable relation' to the probable loss, as anticipated at the time of the contract." *Id.* at 624-25, 500 P.2d at 1047.

175. See *Skendzel v. Marshall*, 261 Ind. 226, 301 N.E.2d 641 (1973), *cert. denied*, 415 U.S. 921 (1974) (clause in a land sale contract between two noncommercial parties found to be a penalty); *In re Associated Gen. Contractors v. Savin Bros., Inc.*, 45 App. Div. 2d 136, 356 N.Y.S.2d 374 (1974), *aff'd*, 36 N.Y.2d 957, 335 N.E.2d 859, 373 N.Y.S.2d 555 (1975) (contract between a national trade association and a large contractor); *Hofer v. W.M. Scott Livestock Co.*, 201 N.W.2d 410 (N.D. 1972) (penalty found in sales agreement between religious organization and a livestock company and an individual); *Babler Bros., Inc. v. Hebener*, 267 Ore. 414, 517 P.2d 653 (1973) (penalty found in contract between road contractor and quarry operators). *But cf.* *Blank v. Borden*, 11 Cal. 3d 963, 524 P.2d 127, 115 Cal. Rptr. 31 (1974):

[I]t is important to recognize that we are not here concerned with a situation wherein the party who seeks to enforce the clause enjoyed a vastly superior bargaining position at the time the contract was entered into. On the contrary, the contract before us was one which was freely negotiated by parties dealing at arm's length. While contracts having characteristics of adhesion must be carefully scrutinized in order to insure that provisions therein which speak in terms of alternative performance but in fact exact a penalty are not enforced . . . , we believe that in circumstances such as those before us interference with party autonomy is less justified.

Id. at 972, 524 P.2d at 132, 115 Cal. Rptr. at 36. See generally *Sweet, Liquidated Damages in California*, 60 CAL. L. REV. 84 (1972).

vention,¹⁷⁶ it is odd that courts interpose their judgment when the parties have agreed to a damage assessment and no overreaching or unconscionability is involved.

Courts are much more willing to enforce liquidated damage agreements when the amount stipulated by the parties falls below the expectancy level.¹⁷⁷ Performance is not pressured by such awards. In fact, just the reverse is true in many cases: breach is encouraged when the cost of breach is low.

While damages stipulated at a level substantially above or below the expectancy level should lead to inquiries about the equality of bargaining power and the possibility of abuse of such power,¹⁷⁸ it is difficult

176. GILMORE 14-15.

177. See *Frank's Nursery Sales, Inc. v. American Nat'l Ins. Co.*, 388 F. Supp. 76, 83 (E.D. Mich. 1974) (validating a \$13,500 liquidated damage award as not shocking the conscience of the court in face of evidence of actual damages of \$18,823.81); *International Distrib. Co. v. American Dist. Tel. Co.*, 385 F. Supp. 871, 874 (D.D.C. 1974) (award of \$446 liquidated damages when loss was \$57,000); *Ray Farmers Union Elevator Co. v. Weyrauch*, 238 N.W.2d 47 (N.D. 1975) (denying damages in excess of the amount stipulated); *Puget Sound Power & Light Co. v. Shulman*, 84 Wash. 2d 433, 440, 526 P.2d 1210, 1214-15 (1974).

178. See *Mahoney v. Tingley*, 85 Wash. 2d 95, 529 P.2d 1068 (1975), *rev'g* 10 Wash. App. 814, 520 P.2d 628 (1974). The appellate court had held that:

The issue to be determined is whether, at the time the stipulation was entered into, the forecast of damages was unreasonably high or unreasonably low for the breach involved. If the forecast of damages is unreasonably high, the stipulation calls for a nonenforceable penalty. If the forecast is unreasonably low, a court will not penalize the innocent party by limiting his recovery to the damages stipulated [*citing C. McCORMICK, DAMAGES 608 (1935), and cases cited therein*].

10 Wash. App. at 818-19, 520 P.2d at 633. In reversing, the supreme court recognized the existence of authorities supporting the appellate court's conclusion, but said:

There is, however, contrary authority. For example, in *Kinston v. Suddreth*, 266 N.C. 618, 146 S.E.2d 660 (1966), the argument was made that a liquidated damages clause, which stipulated an amount less than actual damages, was a penalty and unenforceable. The court refused even to consider the nature of the clause at issue, holding that an injured party cannot recover damages beyond the amount stipulated in a liquidated damages clause. We believe that the view expressed by the North Carolina court is the better one.

. . . .

[I]n addition to a background of case law which suggests that provisions for liquidated damages will ordinarily be upheld by the courts, there are practical considerations which lend further support to our decision We must assume that the seller considered the certainty of a liquidated damages clause to be preferable to the risk of seeking actual damages in the event of the purchasers' breach. We must also assume that the purchasers understood and relied upon the liability limitation stipulated Furthermore, it cannot be ignored that the seller, in making an earnest money agreement, can simply demand more protection—a larger deposit of earnest money—or even dispense

to understand why courts refuse to enforce the stipulation in the absence of overreaching.

A system that permitted parties of equal bargaining power to stipulate the damages assessable on breach of their contract, without reference to expectancy damages, would have much to recommend it.¹⁷⁹ When the breach is clear, as it sometimes is, out-of-court settlement is likely. Even if the issue of breach is unclear and the case is litigated, the trial itself will be simplified substantially by eliminating the damage issue. If the parties are confident that the damage clause will be sustained, they can decide to perform or breach with certain knowledge of the consequences.

If the stipulated amount is nominal, or much less than the value of full performance, a court may find insufficient consideration to support the contract;¹⁸⁰ but if parties of equal bargaining strength wish to deal on that basis, nothing is gained by judicial interference.

C. *One-Sale-Short*

Problem 19. The New Car. Alice, an automobile dealer, and Bob, a school teacher, entered a written contract in September 1974. Alice agreed to sell and Bob to buy a new 1975 model car, serial #2758-098-76, for \$5,200. Bob refused to take delivery of the car and Alice resold it to Clara for \$5,200. Alice could order cars identical to the one Bob agreed to buy, at any time. The car cost Alice \$4,000. What should Alice recover in a suit against Bob?

The situation is similar to the variation of Problem 3 in which a used car was sold for its market price of \$3,000 after the buyer refused to take delivery.¹⁸¹ In Problem 3, Alice could recover only nomi-

with a liquidated damages provision altogether. Except where extraordinary circumstances are involved such as fraud or serious overreaching by the purchaser, a seller who chooses to utilize the device of liquidated damages in an earnest money agreement, with its attendant features of certainty and reliance upon the limitation, cannot avoid the effect of that agreement.

85 Wash. 2d at 99-100, 529 P.2d at 1070-71.

179. See *Blank v. Borden*, 11 Cal. 3d 963, 972, 524 P.2d 127, 132, 115 Cal. Rptr. 31, 36 (1974).

180. [A] promise by the claimant to accept a smaller amount in satisfaction of the existing liquidated debt has seldom been enforced. The payment of an amount that is admittedly due is not regarded as sufficient reason for enforcing a creditor's promise to give up the balance of his claim.

5 A. CORBIN, CORBIN ON CONTRACTS 336 (1964). *But see* note 177 *supra*.

181. See notes 33-37 *supra* and accompanying text.

nal damages, because such a recovery would have left her in as good a position as if the contract had been performed. Are the facts of Problem 19 sufficiently different from those of Problem 3 to warrant a different result?

In Problem 19, Alice could make the sale to Clara whether or not Bob breached. Alice had, for practical purposes, an unlimited supply of cars identical to the one Bob agreed to buy. She could have filled Clara's order without regard to action or inaction by Bob. In Problem 3, however, Alice, holding a used car for sale, did not have a factory source from which to obtain a duplicate of the car she had contracted to sell to Bob. If Bob had performed, she would not have been able to sell an identical item to a new buyer. To some extent—mileage, prior ownership, prior accident record, color, condition of tires, engine and body, etc.—the used car was unique. In theory at least, Bob's breach made it possible for Alice to resell the same used car she had contracted to sell to him. The ability of a new-car dealer to make a second sale of an identical item without regard to the original buyer's performance is the major difference between Problems 19 and 3; that difference calls for a different result.

The seller of a used car is in a position like that of the employee in Problem 14, who, as a result of the employment contract, cannot sell his services during the hours of the working day committed to the original employer.¹⁸² As with the employee, were it not for Bob's failure to perform, no additional commitment could be made concerning the specific car. The market value of the car, like earnings of the employee after breach, mitigates damages because the resale would not have been possible but for the breach.

The seller in Problem 19 would not reach her expectancy goal if granted only nominal damages. Because she could sell the car to Clara without regard to Bob's breach, and because she would have made a profit on the sale to Clara without Bob's breach, Alice would have made one sale more during the 1975 model year had Bob performed. Thus, nominal damages would leave Alice with a \$1,200 loss of profits. Like the plumbing contractor in Problem 16, who, because of her ability to take on additional work, can avoid a setoff of the profits on her second contract, Alice can make a second sale without regard to Bob's breach.¹⁸³

182. See notes 131-45 *supra* and accompanying text.

183. See notes 149-58 *supra* and accompanying text.

In Problem 19, Alice should be awarded \$1,200 in lost profits.¹⁸⁴ Awarding a lesser amount would leave her in a less favorable position than if the buyer had performed.

The contract-price-minus-market-price formula for expectancy assumes that the seller has a limited supply of goods and that the resale after breach is only possible because the original buyer has failed to perform as promised. Whenever the seller's supply is ample, the formula does not achieve expectancy because the ability to resell is unrelated to the breach.

The Uniform Commercial Code¹⁸⁵ provides damages based on the loss of profit, rather than the difference between contract and market price, whenever the latter would fall short of putting the seller in as good a position as performance would have done. Cases involving "all standard priced goods" are said to fall within this provision.¹⁸⁶

It is difficult to understand why the lost-profits measure of damages is appropriate when the goods have standard prices, unless "standard priced goods" mean goods produced in large quantities by producers

184. See *Torkomian v. Russell*, 90 Conn. 481, 485-86, 97 A. 760, 761-62 (1916); *Service Co. v. Sales Co.*, 259 N.C. 400, 415-17, 131 S.E.2d 9, 21 (1963). For a Uniform Sales Act case, see *Stewart v. Hansen*, 62 Utah 281, 285-86, 218 P. 959, 960-62 (1923).

185. UNIFORM COMMERCIAL CODE § 2-708(2). The cases fall into three categories:

(1) Buyer's breach of a contract to buy specialized goods having no general market price. See *Alter & Sons, Inc. v. United Eng'rs & Constructors, Inc.*, 366 F. Supp. 959, 966 (S.D. Ill. 1973) (pumping equipment for a nuclear power plant); *Anchorage Cent. Distrib. Co. v. Van Wormer & Rodrigues, Inc.*, 443 P.2d 596, 599 (Alas. 1968) (coins commemorating Anchorage's centennial); *Detroit Power Screwdriver Co. v. Ladney*, 25 Mich. App. 478, 485-89, 181 N.W.2d 828, 832-34 (1970); *Chicago Roller Skate Mfg. Co. v. Sokol Mfg. Co.*, 185 Neb. 515, 517-18, 177 N.W.2d 25, 27 (1970) (parts for skate boards); *Industrial Circuits Co. v. Terminal Communications, Inc.*, 26 N.C. App. 536, 541-44, 216 S.E.2d 919, 922-24 (1975) (printed electronic circuits).

(2) Buyer's breach of contract causing seller to lose sales. See *Famous Knitwear Corp. v. Drug Fair, Inc.*, 493 F.2d 251, 253-55 (4th Cir. 1974); *Distribu-Dor, Inc. v. Karadanis*, 11 Cal. App. 3d 463, 469-70, 90 Cal. Rptr. 231, 235-36 (1970) (lost-volume analysis, seller was a middleman); *Coast Indus. Inc. v. Noonan*, 4 Conn. Cir. Ct. 333, 336-38, 231 A.2d 663, 665-66 (1967); *Neri v. Retail Marine Corp.*, 30 N.Y.2d 393, 285 N.E.2d 311, 334 N.Y.S.2d 163 (1972).

(3) Buyer breaching a contract to buy goods which are not specialized but for which there is no market. See *Holiday Mfg. Co. v. B.A.S.F. Systems, Inc.*, 380 F. Supp. 1096, 1105 (D. Neb. 1974) (lost profits under § 2-708(2); no indication why the contract-price-market-price test of § 2-708(1) was not used); *Timber Access Indus. v. U.S. Plywood-Champion Papers, Inc.*, 263 Ore. 509, 524-25, 503 P.2d 482, 489-90 (1972).

186. UNIFORM COMMERCIAL CODE § 2-708, Comment 2.

able to establish standard prices. If "standard priced" merely means that the contract and market prices are the same, the standard pricing arrangement is irrelevant in deciding that the contract-price-market-price formula is inadequate to put the aggrieved seller in as good a position as if there had been performance. The supply of goods, not the pricing arrangement, determines the outcome.

In many cases, and probably in most commercial contexts, sellers have practically unlimited supplies of identical goods and a second sale is not dependent on the buyer's breach. The recovery of lost profits, therefore, should be the norm for commercial sales, and not the exception, if expectancy is the goal. By permitting the recovery of lost profits only if the contract-price-market-price formula does not yield expectancy, the Code appears to establish the lost-profit measure as the exception rather than the rule. The courts have not been reluctant to use section 2-708(2), however, and the awarding of lost profits dominates the reported cases.¹⁸⁷ The lost-profits award, by raising the cost of the breach, tends to apply greater pressure on the buyer to perform.

D. *Action for the Price*

If a buyer of goods or services repudiates a contract when the goods or services involved have a market price of zero—when they cannot be sold to anyone else—the aggrieved seller can recover the full contract price under the contract-price-minus-market-price formula. Thus,

187. The index to volumes 1-18 of the *Uniform Commercial Code Reporting Service* shows 21 cases which apply either § 2-708(1) or § 2-708(2) on behalf of an aggrieved seller. Of these, 14 find the lost-profit measure appropriate and 7 award the contract-price-market-price differential. For the cases applying § 2-708(2), see note 185 *supra*; *Alter & Sons, Inc. v. United Eng'rs & Contractors, Inc.*, 366 F. Supp. 959 (S.D. Ill. 1973). See also *City of Louisville v. Rockwell Mfg. Co.*, 482 F.2d 159, 165-66 (6th Cir. 1973); *American Metal Climax, Inc. v. Essex Int'l, Inc.*, 16 UCC REP. SERV. 101, 113-16 (S.D.N.Y. 1974); *White Motor Corp. v. Northland Ins. Co.*, 315 F. Supp. 689, 694 (D.S.D. 1970); *Jericho Sash & Door Co. v. Building Erectors, Inc.*, 362 Mass. 871, 286 N.E.2d 343 (1972) (rescript opinion). The § 2-708 index of the *Uniform Commercial Code Reporting Service* cites the following cases which apply the contract-price-market-price formula of § 2-708(1): *In re Augustin Bros. Co.*, 460 F.2d 376, 382 (8th Cir. 1972); *Bache & Co. v. International Controls Corp.*, 339 F. Supp. 341, 352-53 (S.D.N.Y.), *aff'd*, 469 F.2d 696 (2d Cir. 1972); *Procter & Gamble v. Lawrence Am. Field Warehousing Corp.*, 16 N.Y.2d 334, 354-55, 213 N.E.2d 873, 878, 266 N.Y.S.2d 785, 792-93 (1965); *Miller v. Belk*, 23 N.C. App. 1, 6, 207 S.E.2d 792, 795 (1974); *Jagger Bros., Inc. v. Technical Textile Co.*, 202 Pa. Super. 639, 198 A.2d 888 (1964); *French v. Sotheby & Co.*, 470 P.2d 318, 322 (Okla. 1970); *Carnes Constr. Co. v. Richards & Conover Steel & Supply Co.*, 10 UCC REP. SERV. 797, 803 (Okla. Ct. App. 1972).

when an employee is dismissed in violation of a one-year employment contract with six months yet to run, and the employee cannot find other employment during the balance of the contract term, the employee can recover six months' salary.¹⁸⁸ The market value of the employee's services during the remaining six-month period is zero. The full contract price must be paid although the employee rendered no services to the employer during the balance of the term. When a buyer breaches a contract for sale of goods and the seller cannot resell the goods, the seller, while retaining the goods, can recover the full contract price, or, at a minimum, the contract price minus whatever salvage value the goods have.

On the surface, at least, no special rule is necessary when the goods involved cannot be resold. If the market price of the item sold is zero, applying the normal contract-price-market-price formula leads to recovery of the contract price. The Uniform Commercial Code, however, has developed a special rule. In contracts for the sale of goods, when the market price is zero, or approximates zero, section 2-709 of the Code requires the seller to hold the goods for the buyer and to hand them over to the buyer upon payment of a judgment for the price.¹⁸⁹ If the seller resells the goods before collecting the judgment, the buyer is entitled to have the proceeds of the resale credited against the judgment. In the absence of resale pending collection of judgment, a price action under section 2-709 amounts to a suit for specific performance.

The requirement that the proceeds of resale be deducted from a judgment under section 2-709 is completely at odds with the seller's option to cover or not in other actions for breach of contract for the sale of goods. It also conflicts with the rule in other actions that market price is fixed at the time of breach. In an action under section 2-708 (1), for instance, the seller probably can recover the contract-price-market-price differential regardless of whether the goods thereafter sold for more than the market price.¹⁹⁰ And if the market price is very low at the time of breach, and rises rapidly thereafter, permitting a resale at a higher price, the buyer who breaches remains liable for the difference between the contract price and the low market price at the

188. See, e.g., *Rabago-Alvarez v. Dart Indus., Inc.*, 55 Cal. App. 3d 91, 97-99, 127 Cal. Rptr. 222, 225-27 (1976).

189. UNIFORM COMMERCIAL CODE § 2-709.

190. See note 47 *supra*.

time the buyer learned of the breach. Under section 2-709, however, the later resale price is deducted from the award.

Nothing in the Code, however, expressly requires the aggrieved party to use section 2-709 in seeking expectancy damages.¹⁹¹ The seller seems to have the option of using the contract-price-market-price formula of section 2-708(1). Under it, the seller can recover the contract price minus zero, or almost zero, and need not hold the goods for the buyer. The dollar recovery will be close to that awarded under section 2-709 without the burden of holding the goods. And under section 2-708(1) whatever is gained by a postbreach resale remains the seller's property. Unless section 2-709 is the exclusive remedy when "the seller is unable after reasonable effort to resell . . . [the goods] at a reasonable price,"¹⁹² the aggrieved seller would be foolish to employ section 2-709 instead of section 2-708(1).

Nor will section 2-709 necessarily benefit the buyer. Apparently, section 2-709 simply permits a breaching buyer to acquire the goods when compelled by a judgment to pay the full contract price. If the goods in fact have no market value, however, the buyer gets nothing of value when the goods are delivered. If the goods have value but cannot be resold "at a reasonable price," the buyer will get goods of some value but goods the buyer does not want. The seller, who is in the business of selling, normally will find it easier to dispose of the goods than will the buyer. And if the goods are sold at market by the buyer, he or she will occupy exactly the same position as if the seller had obtained the contract-price-market-price differential under section 2-708 (1); and a section 2-708(1) recovery would have saved the buyer the time and trouble of disposing of the goods.

If the goods are specially manufactured for the buyer and unusable by anyone else, a rule requiring the seller to turn the goods over to the buyer seems economically efficient. If the buyer does not use the goods, no one else will. The buyer, however, might have repudiated for any number of reasons. The buyer might go out of business completely, or modify production in a way that precludes use of the goods except at great economic sacrifice. If so, the buyer has no more use for the goods than anyone else. If the repudiation is based on a decision that the price is too high to permit the profitable use of the goods, however, delivery to the buyer on payment of the contract price makes

191. UNIFORM COMMERCIAL CODE § 2-703, establishing the seller's remedies, does not appear to give exclusivity to any single remedy.

192. UNIFORM COMMERCIAL CODE § 2-709(1)(b).

economic sense by avoiding complete economic waste of the seller's efforts. Since the buyer is forced to pay the contract price in any event—whether he or she gets the goods or not—the buyer who breaches because the price is too high should be able to cut losses by using the goods once payment is made.

Even if section 2-709 would eliminate some waste, however, it is difficult to find a case in which the prospect of a recovery greater than that available under section 2-708 would induce the seller to choose the price remedy.¹⁹³

VI. NON-EXPECTANCY RECOVERIES

While this Article is concerned principally with the traditional theory of expectancy damages, the parties often employ other theories of recovery when an enforceable promise is breached. Effective evaluation of the expectancy system therefore requires examination of its role within the context of the entire system of money recoveries available in suits for failure to perform as promised.

The other theories may be summarized as follows:

1. **Reliance.** When a promise supported by consideration is breached and expectancy damages are too remote and speculative to be ascertained, the injured party may recover expenses incurred in reasonable reliance on the other party's promise. The amount recoverable is limited by the same foreseeability test that limits recovery of expectancy damages.¹⁹⁴

2. **Restitution.** The injured party may recover the value of the performance rendered prior to the breach. The recovery is not limited by the contract price. Restitution is not available if the injured party has performed fully and the breach is the refusal to pay money due and owing.¹⁹⁵

3. **Restitution for the party in default.** The party who breaches after rendering nonreturnable services may recover the value of the

193. *But see* City of Louisville v. Rockwell Mfg. Co., 482 F.2d 159 (6th Cir. 1973). Parking meters were manufactured by Rockwell for the City, delivery was refused, and the meters were unsold and unsalable. The § 2-709 recovery allowed—the purchase price—was identical with what a contract-price-market-price recovery under § 2-708(1) would have been, the market price of the meters apparently having been zero. *Id.* at 165.

194. *See* notes 198-207 *infra* and accompanying text.

195. *See* notes 208-19 *infra* and accompanying text.

benefit conferred on the other party to the extent that such benefit exceeds the damages caused by the breach. Such recovery is limited to a maximum of the pro rata share of the contract price.¹⁹⁶

4. Promissory estoppel. The aggrieved party may recover an amount sufficient to eliminate the injustice resulting from the failure of the breaching party to perform as promised.¹⁹⁷

A. *Reliance Damages*

When it is impossible to assess expectancy damages because of the difficulty of calculating the expectancy position of the aggrieved party, courts may award the expenses incurred in reasonable reliance on the other party's promises.¹⁹⁸

Problem 20. A Revolutionary Switch. In January, Alice, a furnace manufacturer, rented space for the National Furnace Show to be held in Birmingham, Alabama, in the fall. She agreed to pay \$2,000 for the space. Early in August, Alice wrote the following letter to the K. & Q. Transit Company:

I want to arrange for the shipment of 40 parcels from my plant site in Los Angeles to Birmingham, Alabama, for the September 22-25 National Furnace Show. The parcels must arrive in Birmingham by September 20 so that they can be unpacked and the parts assembled. Each parcel will contain a part of a furnace. I plan to unveil for the first time a revolutionary new burner mechanism, a mechanism that will convert from gas to oil or to coal with a flick of a switch. It is imperative that the parcels arrive in time. Unless we can assemble and demonstrate the burner, the whole venture will be a waste of time and money. If we can demonstrate, I am confident that I can sell two million dollars in furnaces at the show. What do you suggest concerning a special handling to assure that the parcels arrive?

196. See notes 220-26 *infra* and accompanying text.

197. See notes 227-28 *infra* and accompanying text.

198. See *In re Las Colinas, Inc.*, 453 F.2d 911, 914 (1st Cir. 1971), *cert. denied*, 405 U.S. 1067 (1972) (citing RESTATEMENT OF CONTRACTS § 333 (1932)); *O'Bier v. Safe-Buy Real Estate Agency, Inc.*, 256 Ark. 574, 576, 509 S.W.2d 292, 293 (1974); *Mendoyoma, Inc. v. County of Mendocino*, 8 Cal. App. 3d 873, 881, 87 Cal. Rptr. 740, 745 (1970); *Beefy Trail, Inc. v. Beefy King Int'l, Inc.*, 267 So. 2d 853, 856 (Fla. Ct. App. 1972) (dicta: "[t]he basic reason for such allowance is that profits may be too speculative to form a part of any damage award"); *King v. Beatrice Foods Co.*, 89 Idaho 52, 57, 402 P.2d 966, 967 (1965); *C.C. Hauff Hardware, Inc. v. Long Mfg. Co.*, 260 Iowa 30, 35, 148 N.W.2d 425, 428 (1967); Fuller & Perdue, *The Reliance Interest in Contract Damages: I & 2*, 46 YALE L.J. 52, 373 (1936, 1937).

K. & Q. answered that no special handling was necessary and that if the parcels were delivered to their agent in Los Angeles by September 1, they would guarantee delivery in plenty of time. Alice delivered the 40 parcels to the K. & Q. agent on August 31st. Thirty-nine of the 40 parcels arrived in Birmingham on September 18. The 40th parcel, containing the "revolutionary" switching mechanism, arrived on September 29, four days after the show closed. Consequently, Alice could not demonstrate the new switching device and received no orders.

Alice filed suit for \$200,000, the amount of profits allegedly lost as a result of her failure to demonstrate the new burner at the show. The court ruled that Alice could not recover lost profits because she could not show that such profits would have resulted had the 40th parcel arrived and the burner been demonstrated. Such damages were "too remote and speculative" to be awarded.

The court gave Alice leave to amend, however, and she then requested "reliance" damages as follows:

- (i) \$1,750 — Travel and hotel bills for Alice and four employees
- (ii) \$6,000 — Salaries paid to the four employees and to Alice from September 19 (when they flew from Los Angeles to Birmingham) to September 25 (when they returned to Los Angeles)
- (iii) \$ 200 — Cost of shipping the 40 parcels from Los Angeles to Birmingham (prepaid)
- (iv) \$ 200 — Cost of shipping the 40 parcels from Birmingham to Los Angeles
- (v) \$2,000 — Cost of booth rental
- (vi) \$7,500 — Cost of cocktail party sponsored by Alice on September 22 for prospective customers, which expenditure was wasted when she was unable to demonstrate the "revolutionary" switch
- (vii) \$ 900 — Cost of fruitless efforts made on September 20 and 21 to have a substitute switch shipped to Birmingham

As a result of K. & Q.'s breach, Alice's expenditures in relationship to the National Furnace Show were commercially useless. Travel and hotel costs (i), salaries paid (ii), and shipping costs (iii and iv) all were expenditures made in reasonable reliance that K. & Q. would deliver the parcels as promised, and were foreseeable by K. & Q. These expenses would be included in a reliance award to Alice.¹⁹⁹

199. See *Security Store & Mfg. Co. v. American Ry. Express Co.*, 227 Mo. App. 175, 179-80, 51 S.W.2d 572, 574-75 (1932), the case on which Problem 20 was modeled. See

Unless the four employees were hired solely for the Furnace Show, they probably would have drawn the same salaries whether or not Alice contracted with K. & Q. Arguably, therefore, the \$6,000 salary expense was incurred not in reliance on K. & Q. performing as promised, but as a normal business expense.²⁰⁰ But Alice still should recover the \$6,000 salary expense on the theory that she, reasonably and foreseeably relying on K. & Q.'s promise, diverted her own efforts and those of her employees from other company-related, presumably profitable, activities.²⁰¹

The obligation to rent the booth at the Furnace Show for \$2,000 was incurred before K. & Q. committed itself to deliver the parcels and, therefore, was not an expense incurred in direct reliance on the contract. If K. & Q. were a common carrier, however, it would be obliged to carry any nondangerous goods Alice wished to ship. Arguably, therefore, the \$2,000 rental expense was made in reliance on K. & Q. performing its duties as a common carrier.²⁰²

K. & Q.'s obligation to pay the \$7,500 cocktail party expense would depend on a finding that such an expenditure was foreseeable when Alice and K. & Q. entered the contract.²⁰³ Although apparently far removed from a contract to carry parcels to a furnace show, the cock-

also Applied Data Processing, Inc. v. Burroughs Corp., 394 F. Supp. 504, 508-09 (D. Conn. 1975); Saddler v. United States, 287 F.2d 411, 415-16 (Ct. Cl. 1961); Schnierow v. Boutagy, 33 Cal. App. 336, 337, 164 P. 1132, 1133 (1917); King v. Beatrice Foods Co., 89 Idaho 52, 57, 402 P.2d 966, 968 (1965); Chicago Coliseum Club v. Dempsey, 265 Ill. App. 542, 552-53 (1932).

200. *See* Chicago Coliseum Club v. Dempsey, 265 Ill. App. 542, 553 (1932) (defendant not required to reimburse plaintiff for "salaries paid regular officials of the [plaintiff] corporation who were presumed to be receiving such salaries by reason of their position").

201. *See, e.g.,* Security Store & Mfg. Co. v. American Ry. Express Co., 227 Mo. App. 175, 51 S.W.2d 572 (1932). *See also* Mendoyoma, Inc. v. County of Mendocino, 8 Cal. App. 3d 873, 881-82, 87 Cal. Rptr. 740, 745 (1970); C.C. Hauff Hardware, Inc. v. Long Mfg. Co., 260 Iowa 30, 35, 148 N.W.2d 425, 428 (1967) (plaintiff awarded the value of his own services and those of two employees).

202. Security Store & Mfg. Co. v. American Ry. Express Co., 227 Mo. App. 173, 184, 51 S.W.2d 572, 577 (1932).

203. *E.g.,* Mendoyoma, Inc. v. County of Mendocino, 8 Cal. App. 3d 873, 880, 87 Cal. Rptr. 740, 744 (1970) (plaintiff had intended to raise capital by sale of stock but later decided to raise funds by means of loans; defendant not liable for the interest paid since the loans were not foreseeable); Freund v. Washington Square Press, Inc., 34 N.Y.2d 379, 383, 314 N.E.2d 419, 421, 357 N.Y.S.2d 857, 860 (1974) (lost profits not available to plaintiff because too speculative to be awarded). *See also* Gurney Indus., Inc. v. St. Paul Fire & Marine Ins. Co., 467 F.2d 588, 598-99 (4th Cir. 1972).

tail party would be foreseeable if such entertaining were the norm in the industry and K. & Q. had reason to know of that norm. Whatever the norm, if K. & Q. had no reason to anticipate such an expenditure, Alice could not recover the \$7,500 even though K. & Q.'s breach made the expenditure a useless one.²⁰⁴

It is difficult to view the \$900 expenditure in search of alternate transportation as an expenditure in *reliance* on K. & Q.'s performing as promised. Although the expenditure would have been unnecessary but for K. & Q.'s breach, Alice incurred the expense after she knew that K. & Q. had breached, and therefore was not relying on performance by K. & Q.²⁰⁵

In its pure form, the reliance damage test returns the aggrieved party to the position occupied prior to having entered the contract. Since the expectancy position cannot be determined, leaving the aggrieved party in *status quo ante* seems a reasonable alternative. At least the aggrieved party is not affirmatively harmed by the breach. Because of the limitations of the foreseeability test and the denial of recovery for reasonable postbreach efforts to repair the damage done, however, the aggrieved party is unlikely to achieve precontract status. The aggrieved party may end up aggrieved indeed. The interest in avoiding the imposition of large and unforeseen damages on the party who breached outweighs the interest in returning the aggrieved party to her or his precontract position. The risk of loss is shared by both parties.

Even though a court cannot determine the aggrieved party's expectancy position with sufficient accuracy to award expectancy damages, if the breaching party can show that the aggrieved party would have lost money absent a breach, the theory would permit only nominal damages.²⁰⁶ If K. & Q. could show that the burner, if assembled, would

204. See *Schnierow v. Boutagy*, 33 Cal. App. 336, 337, 164 P. 1132, 1133 (1917) ("the parties, when they made the contract, did not contemplate that plaintiff . . . should give his property away or sell it at a sacrifice"); *C.C. Hauff Hardware, Inc. v. Long Mfg. Co.*, 260 Iowa 30, 35, 148 N.W.2d 425, 428 (1967).

205. See *Chicago Coliseum Club v. Dempsey*, 265 Ill. App. 542, 551-52 (1932) (no right to recover for expenses incurred in obtaining an injunction after defendant repudiated the contract); cf. *Brown Bros. Equip. Co. v. State Highway Comm'n*, 51 Mich. App. 448, 451, 215 N.W.2d 591, 593 (1974) (no right to recover cost incurred in relocating facilities after defendant breached contract). If Alice's \$900 expenditure is viewed as a reasonable effort to mitigate damages, it might be recovered. See *Tampa Elec. Co. v. Nashville Coal Co.*, 214 F. Supp. 647, 652 (M.D. Tenn. 1963); *Cain Shoes, Inc. v. Gunn*, 194 Kan. 381, 384, 399 P.2d 831, 834 (1965).

206. See notes 33-34 *supra*. See also *In re Yeager Co.*, 227 F. Supp. 92, 98-99 (N.D. Ohio 1963); RESTATEMENT OF CONTRACTS § 333(d) (1932); Fuller & Perdue, *supra* note 198, at 79.

have exploded causing injuries, or that it would have functioned so imperfectly that no sales would have been made, reliance damages would be inappropriate.²⁰⁷ In such situations, Alice's reliance expenditures would have been useless even if K. & Q. had performed as promised.

B. Restitution

Although a claim for reliance damages generally succeeds only when expectancy damages cannot be awarded,²⁰⁸ restitution is available to the aggrieved party whether or not expectancy damages are available.²⁰⁹ In seeking restitution, the aggrieved party asks for the return of the dollar equivalent or value of the performance in a context in which return of the subject of the contract is not feasible.²¹⁰ Thus, restitution is irrelevant to a wholly executory contract, in which neither party has given anything of value to the other; the remedy is most useful in construction cases²¹¹ and is available in some service-contract situations.²¹²

Problem 21. The Owner's Mistake. Alice entered a contract to build a house for Bob. Alice agreed to construct the house according to plans and specifications supplied by Bob and Bob agreed to pay Alice \$90,000 for the job, payments to be made as follows: \$15,000 when the

207. See note 206 *supra*.

208. See note 198 *supra*.

209. See *Acme Process Equip. Co. v. United States*, 347 F.2d 509, 528-29 (Ct. Cl. 1965); *Royal Manor Apartments v. Powell*, 258 Ark. 166, 170, 523 S.W.2d 909, 911 (1975); *Curators of the Univ. of Mo. ex rel. Shell-Con., Inc. v. Nebraska Prestressed Concrete Co.*, 526 S.W.2d 903, 911 (Mo. Ct. App. 1975); *Dravo Corp. v. L.W. Moses Co.*, 6 Wash. App. 74, 90, 492 P.2d 1058, 1068-69 (1971).

210. Materials and services furnished in most construction and service contracts are incapable of being returned, and their value may be recovered. See, e.g., *Dale's Serv. Co. v. Jones*, 96 Idaho 662, 665, 534 P.2d 1102, 1105-06 (1975); RESTATEMENT OF CONTRACTS § 347, Comment b (1932).

211. See note 215 *infra* for illustrations of restitution in the construction area. Construction contracts often are complex and give rise to difficult legal and factual questions. The parties may be unsure which of them breached, whether one or the other waived any rights or whether the contract was substantially performed. Thus, parties tend to plead their case on several alternative theories, often including alternatively a contract theory and a restitution-quantum meruit theory. See *Scaduto v. Orlando*, 381 F.2d 587, 594-96 (2d Cir. 1967).

212. For examples of restitution in the employment-service contract area, see *Dade County v. Palmer & Baker Eng'rs, Inc.*, 318 F.2d 18, 24 (5th Cir. 1963) (design and construction engineering company which was discharged permitted to recover "the value of the services [it had] rendered"); *Musgrove v. Leonard*, 97 Ariz. 44, 46-47, 396 P.2d 614, 616 (1964); *Parrish v. Tahtaras*, 7 Utah 2d 87, 91, 318 P.2d 642, 645 (1957) (architect may plead in the alternative on the contract and for quantum meruit).

foundation was in, \$15,000 when the house was framed and roofed, and the balance when the house was completed. After the foundation was in and before the house was framed and roofed, Bob repudiated the contract and ordered Alice off the job. He had not paid her and she had spent \$45,000. Alice had seriously underestimated her costs, and had she completed the house as agreed, it would have cost her \$120,000, including the \$45,000 she had already spent. Bob hired Clarice to finish the job. He paid her \$100,000 to complete it.

If Alice sued for expectancy damages, she would recover the contract price (\$90,000) minus her cost to complete (\$75,000), or \$15,000. Since Alice had spent \$45,000 at the time of the breach, the expectancy award would leave her with a \$30,000 loss. Had Bob not breached and had Alice completed the house, she would have spent \$120,000 and received \$90,000, thus suffering the same \$30,000 loss.

If Alice chose a restitutionary recovery rather than expectancy, she could recover the value of the work she had done, very probably \$45,000, thus avoiding any loss on the contract.²¹³ Although restitution generally permits the aggrieved party to recover the "value" of the work retained by the party who breached,²¹⁴ in construction contracts "value" often is equated with the amount the aggrieved party spent on the job.²¹⁵

213. See *Philadelphia v. Tripple*, 230 Pa. 480, 79 A. 703 (1911) (full restitutionary recovery by plaintiff who had made a losing contract). See also *Scaduto v. Orlando*, 381 F.2d 587, 595 (2d Cir. 1967); *Acme Process Equip. Co. v. United States*, 347 F.2d 509, 528-30 (Ct. Cl. 1965); *Dravo Corp. v. L.W. Moses Co.*, 6 Wash. App. 74, 91, 492 P.2d 1058, 1069 (1971).

214. See *Dale's Serv. Co. v. Jones*, 96 Idaho 662, 534 P.2d 1102 (1975):

Under a quantum meruit theory, the proper measure for recovery is the value of the actual benefit realized and retained by the recipient of the services and material. To arrive at this figure, the trial court on remand should: 1. Compute the fair market value of the services provided and material furnished by . . . [the subcontractors] before being terminated by . . . [the contractor], considering the necessity to cure any substandard work, 2. Less the remuneration . . . [the subcontractor received] for performing their services and furnishing the fill.

Id. at 666, 534 P.2d at 1106. See also *Goff v. Graham*, — Ind. App. —, —, 306 N.E.2d 758, 767 (1974); RESTATEMENT OF CONTRACTS § 347, Comment b (1932).

215. See *United States ex rel. Susi Contracting Co. v. Zara Contracting Co.*, 146 F.2d 606, 611 (2d Cir. 1944); *United States ex rel. E. & R. Constr. Co. v. Guy H. James Constr. Co.*, 390 F. Supp. 1193, 1222 (M.D. Tenn. 1972), *aff'd*, 489 F.2d 756 (6th Cir. 1974); *Meinhardt v. Investment Builders Properties Co.*, — Colo. App. —, —, 518 P.2d 1376, 1379 (1973) (following owner's breach of a construction contract, contractor permitted to recover amount expended on job as determined by contractor's records); *Philadelphia v. Tripple*, 230 Pa. 480, 487, 79 A. 703, 706 (1911); *Dravo Corp. v. L.W. Moses Co.*, 6 Wash. App. 74, 92, 492 P.2d 1058, 1069 (1971). Cf. *Acme Process Equip. Co.*

Bob, who contracted to pay \$90,000 for the house, would pay \$145,000 as the result of his breach—\$45,000 to Alice in damages and \$100,000 to Clarice to finish the house. Alice would receive a \$30,000 windfall as the result of Bob's breach. As noted above, the same sanction-windfall pattern occurs when a party breaches a favorable contract and nominal damages are awarded under the expectancy system. Once again, pressure to perform is applied to the party who least needs such pressure.

The restitutionary remedy is useful only to an aggrieved party who entered an unfavorable contract. Restitution shields the aggrieved party from any expectancy loss. Thus, in Problem 21, if Alice had spent \$45,000 at the time of the breach and could have completed the house for \$40,000, her expectancy award would have been \$50,000 (the \$90,000 contract price minus the \$40,000 cost to complete) and restitution would have yielded only \$45,000, the value (usually the cost) of what she had given.

Problem 22. The Baseball Player. Henry Allen was under contract to play baseball for the Chicago White Sox during the 1976 baseball season at a salary of \$150,000 for the season, payable at the end of the season. The team was to play a 160-game schedule. During the first 80 games of the season, Allen hit 75 home runs, knocked in 150 runs, scored 130 runs, and played errorless ball at first base. After the 80th game, the owner of the club came into the clubhouse, told Allen that Babe Ruth was his idol, that Allen was making shambles of Ruth's records, and that, therefore, Allen was fired. Allen was stunned, but left and looked for other work in baseball. Because of the reserve clause, he was unable to locate any work in the United States. He did get a job with a club in the Japanese Baseball League, however, and finished the season there. They paid \$200,000 for the half season. Allen investigated and discovered evidence that his play for the White Sox during the first 80 games caused an average of 20,000 more people to attend each game than would otherwise have attended. The net gain to the White Sox on the 20,000 extra seats sold per game was \$3.00 per person, \$60,000 more for each of the 80 games, or a total of \$4,800,000 as a result of his play.

Suing in restitution, Allen would be entitled to recover the value of the services he rendered without regard to the contract price.²¹⁰ If his

v. United States, 347 F.2d 509, 531 (Ct. Cl. 1965) (quantum meruit recovery reduced on showing that contractor's costs were excessive).

216. See, e.g., United States *ex rel.* Susi Contracting Co. v. Zara Contracting Co., 146 F.2d 606, 611 (2d Cir. 1944); RESTATEMENT OF CONTRACTS § 347, Comment c (1932).

services were valued in terms of the dollar gain to his employer as the result of Allen's services he would recover \$4,800,000. With such an award, the employer would be returned to the position it occupied before entering the contract with Allen, and Allen would have the dollar equivalent of the services he rendered. If Allen's services over the second half of the season matched those rendered during the first 80 games, a nonbreaching employer would have gained an additional \$4,800,000 at a cost of \$75,000, half of Allen's salary. As a result of the breach, the employer would, of course, forfeit these profits in addition to the \$4,800,000 awarded to Allen.

It is unlikely that Allen would recover \$4,800,000 in his restitutionary action. His services probably would be valued at their market price rather than on the basis of the employer's profits resulting from his services.²¹⁷ If the salary paid Allen by the Japanese Baseball League were evidence of the market value of his services, he could recover \$200,000 for the half season with the White Sox.²¹⁸

It generally makes more sense to value services in terms of their market value than in terms of the dollar gain to the employer. If a guard at Fort Knox single-handedly foils a scheme to steal all of the gold stored there, and then is fired without cause and without being paid, no court would permit the guard to recover an amount equal to the value of the gold.²¹⁹ In Problem 22, if Allen were awarded the market price of his services the employer would still lose the \$4,800,000 expected profit from Allen's services in the second half of the season, and might pay substantially more than the contract rate for the services actually rendered. Allen's employer seems to occupy a better position than the owner of the home in Problem 21. The employer, unlike the owner, would retain part of the benefit of the bargain made.

C. *Restitution on Behalf of Plaintiff in Default*

Problem 10 dealt in part with the rights of a plaintiff in default, but concentrated on methods of calculating the expectancy rights of the

217. If the plaintiff's performance is part of the very performance for which defendant bargained as part of an agreed exchange, it is to be valued, not by the extent to which the defendant's total wealth has been increased thereby, but by the amount for which such materials as constituted the part performance could have been purchased from one in the plaintiff's position at the time they were rendered.

RESTATEMENT OF CONTRACTS § 347, Comment c (1932).

218. See note 217 *supra*.

219. The Fort Knox hypothetical was suggested by Professor Robert C. Baesemann, then of the Department of Economics, Washington University, St. Louis.

aggrieved party. The present discussion emphasizes the recovery rights of the party who breached.

Problem 23. Breaching a Favorable Contract. Alice, a contractor, and Bob, the owner of a lot, entered a contract under which Alice was to build a house on Bob's lot for \$60,000. When the building was one-third complete and Alice had spent \$15,000, she had a dispute with Bob and repudiated the contract. Had Alice completed the house, she would have spent a total of \$45,000 and had a profit of \$15,000. After the repudiation, Bob invited bids for the completion of the house. He accepted the low bid of \$40,000 to finish the house and upon its completion paid \$40,000 to the new contractor and moved into the house. Bob refused Alice's demand for payment and she filed suit against him.

Since Alice breached the contract, an action by her for expectancy damages would be inappropriate.²²⁰ Her recovery, if any, must be under a quantum meruit or restitution theory.²²¹ Bob paid \$40,000 to the second contractor and received a house. Unless required to pay \$20,000 to Alice, Bob would have a windfall by obtaining the house for less than the \$60,000 he agreed to pay. When a plaintiff in default sues in restitution, recovery is limited to the lowest of three figures: (1) a pro rata share of the contract price²²² (so that the party will not

220. See *Jones v. Hartmann*, — Colo. App. —, —, 541 P.2d 123, 125 (1975); *Kirkland v. Archbold*, 68 Ohio L. Abs. 481, 484, 113 N.E.2d 496, 499 (Ohio App. 1953); *Burke v. McKee*, 304 P.2d 307, 308 (Okla. 1956); *Wasserburger v. American Scientific Chem., Inc.*, 267 Ore. 77, 82, 514 P.2d 1097, 1099 (1973); *Lowe v. Rosenlof*, 12 Utah 2d 190, 194, 364 P.2d 418, 420 (1961).

221. The courts do not agree about the right of a plaintiff in default, such as Alice, to recover the value of the net benefit conferred if the failure to perform is wilful or in bad faith. RESTATEMENT OF CONTRACTS § 357 (1932) takes the more restrictive view, permitting recovery by the plaintiff in default only if "the plaintiff's breach or non-performance is not wilful and deliberate . . ." See also *Harris v. The Cecil N. Bean*, 197 F.2d 919, 921-22 (2d Cir. 1952); *Gillis v. Gillette*, 184 F.2d 872, 876 (9th Cir. 1950); *Trachsel v. Barney*, 264 Ore. 29, 34, 503 P.2d 696, 698-99 (1972). A more liberal view, permitting the plaintiff in default to recover the value of the net benefit conferred without regard to the nature of the breach, is found in the landmark case of *Britton v. Turner*, 6 N.H. 481, 26 Am. Dec. 713 (1834). While *Britton v. Turner* was an employment case, it had a substantial impact on construction cases resembling Problem 23. See *Peters v. Halligan*, 182 Neb. 51, 59-60, 152 N.W.2d 103, 109 (1967); *Power-Matics, Inc. v. Ligotti*, 79 N.J. Super. 294, 306-07, 191 A.2d 483, 490 (Super. Ct. App. Div. 1963) ("that plaintiff may have been in wilful default does not bar his recovery for reasonable value"); *Kirkland v. Archbold*, 68 Ohio L. Abs. 481, 485-87, 113 N.E.2d 496, 499-501 (Ohio App. 1953); *Burke v. McKee*, 304 P.2d 307, 308-09 (Okla. 1956).

222. See RESTATEMENT OF CONTRACTS § 357 (1932) ("ratable proportion of the agreed compensation"). If more than a pro rata share of the contract price were recoverable, the defaulting plaintiff would benefit from the breach. In *Britton v. Turner*, 6

profit by breaching); (2) the value of the performance given to the aggrieved defendant²²³ (so that payment is for no more than was received); or (3) an amount which will leave the aggrieved party in at least as good a position as if the contract had been performed²²⁴ (so that the aggrieved party will not suffer any loss from the breach).

A \$20,000 award would accomplish all three objectives in Problem 23. Alice completed one-third of the house; \$20,000 would not exceed a pro rata share of the contract price. Bob paid 40,000 to the second contractor; a \$20,000 payment to Alice would leave Bob in as good a position as if Alice had not breached. If the value of Alice's performance were calculated as the amount it would have cost Bob to have the first portion of the house built by a second contractor, the \$20,000 award would represent such value.

If Alice recovered \$20,000, she would receive \$5,000 of the \$15,000 profit she would have made had she performed. The prospect of receiving that portion of the profit, however, would not encourage Alice to breach the contract. By breaching, she surrendered her right to two-thirds (\$10,000) of the profit she would have earned had she performed in full. In paying the \$20,000 to Alice in addition to \$40,000 to the second contractor, Bob would pay exactly the amount he promised to pay originally. Unless a court wished to punish Alice for having breached, she could recover \$20,000.

The courts evidently value the part performance of a plaintiff in default without regard to the fact that this value may include a portion of profit.²²⁵ Limiting Alice's recovery to \$15,000, by deducting her

N.H. 481, 26 Am. Dec. 713 (1834), plaintiff was permitted to recover a share of the contract price in proportion to the amount of work he performed. *See Texas W. Financial Corp. v. McCraw Candies, Inc.*, 347 F. Supp. 445, 449 (N.D. Tex. 1972) (90 percent of contract price awarded where machine operated at 90 percent of capacity); *Burke v. McKee*, 304 P.2d 307, 309 (Okla. 1956).

223. *See C & S Distribs., Inc. v. Simon*, 4 Conn. Cir. Ct. 631, 634, 238 A.2d 443, 445 (1967); *Peters v. Halligan*, 182 Neb. 51, 60, 152 N.W.2d 103, 109 (1967); *Burke v. McKee*, 304 P.2d 307, 309 (Okla. 1956); *Trachsel v. Barney*, 264 Ore. 29, 34, 503 P.2d 696, 699 (1972) (plaintiff failed to recover partly on the ground that there had been no showing that the work done was beneficial to the defendant); *Sadler v. Middle Tenn. Elec. Member Corp.*, 36 Tenn. App. 495, 499-500, 259 S.W.2d 544, 546 (1953).

224. *See Harris v. The Cecil N. Bean*, 197 F.2d 919, 922 (2d Cir. 1952); *Texas W. Financial Corp. v. McCraw Candies, Inc.*, 347 F. Supp. 445, 449 (N.D. Tex. 1972); *C & S Distribs., Inc. v. Simon*, 4 Conn. Cir. Ct. 631, 634, 238 A.2d 443, 445 (1967); *Power-Matics, Inc. v. Ligotti*, 79 N.J. Super. 294, 307, 191 A.2d 483, 490 (Super. Ct. App. Div. 1963).

225. *See* note 223 *supra*.

profit, would result in a windfall to Bob. Such a limitation, although contrary to the general rule, would be consistent with the tendency to penalize parties who breach favorable contracts.²²⁶

Problem 24. Breaching an Unfavorable Contract. Alice, a contractor, and Bob, a lot owner, entered a contract under which Alice agreed to build a house on Bob's lot for \$75,000. Alice repudiated the contract after she was one-third through with the house and had spent \$28,000 on the job. Had Alice completed the job, she would have spent a total of \$84,000. Bob had the house finished by another contractor to whom Bob paid \$65,000. Bob refused Alice's demand for reimbursement of the \$28,000 she had spent.

Unless required to pay \$10,000 to Alice, Bob would receive the house for less than he contracted to pay for it. If compelled to pay her more than \$10,000, he would pay more for the house than agreed. If Alice received \$10,000 from Bob, she would be \$18,000 out-of-pocket, since her cost at the time of breach was \$28,000. Had Alice performed, she would have spent \$84,000 on the house in return for a \$75,000 payment by Bob. Breach would cost Alice \$9,000 more than performance. If Alice could have predicted this result, she probably would not have breached the contract.

If Bob could have located a contractor to complete the house for \$50,000, less than it would have cost Alice to finish, Alice might have made a case for a \$25,000 award. Bob would receive the house for the \$75,000 contract price; Alice would not recover more than a pro rata share of the contract price; and she would not receive more than the value of the work she had done. One problem would remain. A \$25,000 award would leave Alice only \$3,000 out-of-pocket, a position substantially better than the \$9,000 loss she would have suffered had she performed. Knowledge that she could reduce her loss by \$6,000 would encourage Alice to breach. If the award were less than \$25,000, Bob would receive a windfall, acquiring the house for less than he contracted to pay. One might argue that Bob would receive not a windfall, but a reward for his ability to find contractors to complete the project cheaply. Unless Alice's position after the restitutionary award would be no better than her post-performance position, Alice would profit by her breach. If she could predict such a profit, the economics of the situation would encourage a breach.

226. See notes 54-56, 208-19 *supra* and accompanying text.

D. *Promissory Estoppel*

Promissory estoppel has become a common basis for recovery since the promulgation of Section 90 of the *Restatement of Contracts* in 1932. The tentative draft of *Restatement (Second) of Contracts* has retained Section 90, with the proviso that a promise is enforceable only to the extent necessary to avoid injustice.²²⁷ The partial enforcement doctrine of the *Second Restatement* has received some judicial support.²²⁸

VII. CONCLUSION

The expectancy system's concentration on the status of the aggrieved party leads to damage assessments that, in many situations, neither encourage nor discourage performance. In the absence of consequential damages, a total breach by one who makes a losing contract leaves both parties in their expectancy positions—the aggrieved party by design and the party who breached by accident. With total breach and no consequential damages, the only person encouraged to perform is the one who makes a favorable contract, yet the contract itself encourages such a person to perform. The party who breaches loses the benefit of the bargain and the other party receives a positive reward by being permitted to avoid the loss contracted for.

The consequential damage portion of the expectancy system tends to encourage performance in many situations by placing the party who breaches even a losing contract in a worse position than performance would have achieved. Because parties to contracts are deemed to have relatively limited powers of foresight, however, the aggrieved party often fails to achieve expectancy; because of the foreseeability limitation, performance is often encouraged less strongly than it otherwise

227. RESTATEMENT (SECOND) OF CONTRACTS § 90 (Tentative Drafts 1-7, 1973):

(1) A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise.

228. See *Janke Constr. Co. v. Vulcan Materials Co.*, 386 F. Supp. 687, 697-98 (W.D. Wis. 1974), *aff'd*, 527 F.2d 772 (1976); *Hunter v. Hayes*, — Colo. App. —, 533 P.2d 952, 954 (1975); *Hoffman v. Red Owl Stores, Inc.*, 26 Wis. 2d 683, 701-02, 133 N.W.2d 267, 276-77 (1965). See also *Ehert Co. v. Eaton, Yale & Towne, Inc.*, 523 F.2d 280, 284 (7th Cir. 1975); *Borden v. Chesterfield Farms, Inc.*, 27 App. Div. 2d 165, 168, 277 N.Y.S.2d 494, 497 (1967) (concurring judge argued for the application of the RESTATEMENT (SECOND) test for determining damages). Cf. *E.F. Hutton & Co. v. Fox*, 518 S.W.2d 849, 853 (Tex. Civ. App. 1974 no writ).

would be. Mitigation, of course, also ameliorates the impact of breach on the party failing to perform, further softening the pressure to perform. Not only does the expectancy system tend to adopt a neutral stance toward performance, it operates at times to prohibit the parties from stipulating damages in an amount sufficient to encourage performance.

The availability of restitution as an alternative does not alter the system's neutrality. Restitution, like expectancy, encourages performance by one who makes a favorable contract; it does no more than the expectancy system, however, to encourage performance by those who make unfavorable contracts. And, of course, the goal of restitution—returning the aggrieved party to precontract status—is inconsistent with the expectancy goal.

While the expectancy system has many internal inconsistencies, and in many situations has little or no impact on the decision to perform or to breach, the fact that the Uniform Commercial Code retained most of the expectancy system is some indication that large parts of the commercial world are satisfied with the way it functions. An effective answer to the criticism leveled at the system may be: "It works." Further investigation is necessary to determine whether, in fact, it works well.²²⁹

229. In preparing a primer of the law of expectancy damages, my intention was to establish a starting point for an in-depth study of contract damages. The necessary first step for such a study was an articulation of the traditional doctrines. While the main threads of the traditional concepts of the expectancy system are presented here, it should be understood that the primer is not intended to be more than the name implies—an introduction to basic concepts.