BAR EXAM TOOLBOX

Lee Burgess: Welcome to the Bar Exam Toolbox podcast. Today, we have another in our "Listen and Learn" series – this one is on expectation and consequential damages. Your Bar Exam Toolbox hosts are Alison Monahan and Lee Burgess, that's me. We're here to demystify the bar exam experience, so you can study effectively, stay sane, and hopefully pass and move on with your life. We're the co-creators of the Law School Toolbox, the Bar Exam Toolbox, and the career-related website CareerDicta. Alison also runs The Girl's Guide to Law School. If you enjoy the show, please leave a review on your favorite listening app, and check out our sister podcast, the Law School Toolbox podcast. If you have any questions, don't hesitate to reach out to us. You can reach us via the contact form on BarExamToolbox.com, and we'd love to hear from you. And with that, let's get started.

Lee Burgess: Hello, and welcome back to the "Listen and Learn" series from the Bar Exam Toolbox podcast! Today we are going to be talking about legal remedies for breach of contract. Legal remedies are also known as money damages, and are distinguished from equitable remedies like specific performance, rescission, and reformation. When we talk about legal remedies, we're typically talking about five types of damages: expectation damages, consequential damages, reliance damages, incidental damages, and restitution damages. On this episode we're going to focus on the two most heavily-tested types of legal remedies: expectation damages and consequential damages.

Lee Burgess: Let's start by going over the rules. The general measure of damages for a breach of contract are expectation damages. Expectation damages arise directly from the breach, and are an attempt to put the non-breaching party in the same position it would have been in but for the breach. To recover, the damages must be, one caused by the defendant; two, foreseeable; three, certain – meaning that the damages cannot be speculative; and four, unavoidable – meaning that the plaintiff must take reasonable steps to mitigate his losses. An award of damages must account and deduct for any costs the injured party avoided because of the breach.

Lee Burgess: To illustrate this rule, let's say that I breach an agreement to sell you 100 widgets at $10 per widget. As a result of my breach, you buy replacement widgets from another seller at the lowest cost you can find, which is $11 a widget. You expected to have 100 widgets and to be out $1,000. Instead, you have 100 widgets and are out $1,100. Because of my breach, you are $100 worse off than you would have been if I had performed according to our agreement. So, your expectancy damages are $100. Pretty straightforward, right?

Lee Burgess: Now let's change the facts up a little bit. Let's say that in addition to paying me $1,000 for the widgets, you were also going to have to pay a shipping company $50 to have the widgets shipped to you. The other seller, however, shipped them to you for free. So while you had to pay the other seller $100 more for the widgets, you also avoided the original $50 shipping cost. That $50 must be deducted from your $100 damage award, leaving you with an award of $50 in expectancy damages.

Lee Burgess: Now, let's move on to the rule for consequential damages. Consequential damages arise indirectly from the breach, and are awarded because of the injured party's special circumstances – for example, lost profits. To recover, the damages must be, one, reasonably foreseeable at the time of contract formation; two, arise from the plaintiff's special circumstances that the defendant knew or had reason to know of; and three, reasonably certain. As with expectation damages, an award of damages must account for and deduct for any costs the injured party avoided because of the breach.

Lee Burgess: To illustrate, let's go straight to the source of the rule – the case of *Hadley v. Baxendale*. As you may recall, the plaintiffs in that case operated a mill, which they were forced to shut down when part of their steam engine broke. Plaintiffs then entered into a contract with the defendants for a replacement part for the engine. Delivery of that part was delayed, causing the plaintiffs' mill to remain closed for longer than expected, and the plaintiffs sued. The court held that the plaintiffs were not entitled to damages because the defendants had no reason to know that their breach would result in a longer shutdown of the mill, resulting in lost profits. The plaintiffs never communicated the special circumstances to the defendants, and the defendants were not otherwise aware of those circumstances.

Lee Burgess: Okay, that covers our main rules for expectation and consequential damages. But before we move on to our first hypo, let's take a minute to dive deeper into mitigation. While mitigation is specifically included in our rule for expectation damages, it's actually a general limitation on legal remedies for breach of contract. Simply put, a plaintiff cannot recover damages as a result of a breach that could have been avoided. Accordingly, a party must take reasonable steps to mitigate their losses. If they fail to do so, the court will reduce the total damages by the amount that could have been avoided.

Lee Burgess: Now, you might be asking yourself what constitutes "reasonable steps"? Well, it depends on the facts of the case, but here are three relevant rules, each dealing with a different mitigation scenario:

Lee Burgess: First, once a party has reason to know that performance by the other party will not be forthcoming, they are ordinarily expected to stop their own performance to avoid further expenditure. Second, affirmative steps to avoid loss are not required if they involve undue risk, burden, or humiliation. Third, whether an available alternative transaction is a suitable substitute depends on all the circumstances, including the similarity of performance.

Lee Burgess: So, that's it for our rules. Let's get to our first hypo, which is based on a question from the California bar exam:

Lee Burgess: "Paul and Debra entered into a valid written contract for Paul to remodel Debra's kitchen. Paul agreed to perform the work for $15,000, payable upon completion. Paul estimated that he would work approximately 20 hours a week and would complete the project in five weeks.

Lee Burgess: Paul completed four weeks of work on the project when Debra unjustifiably repudiated the contract. Paul was able to get another smaller remodeling job in the fifth week, which paid $1,000 and took 10 hours to complete. He could have completed Debra's project at the same time.

Lee Burgess: At the time Debra unjustifiably repudiated the contract, Paul was negotiating with Tiffany to remodel her bathroom for $10,000. When Tiffany heard that Debra cancelled the contract, she stopped negotiating with Paul.

Lee Burgess: Paul has sued Debra. Can Paul recover expectation or consequential damages, and if so, in what amounts?"

Lee Burgess: So, the question here is specifically asking us about damages, and we're told that Debra unjustifiably repudiated the contract, so we don't need to deal with any other contract issues. We can assume that there was a valid contract and a breach, and focus solely on what remedies are available.

Lee Burgess: So let's take each remedy in order, starting with expectation damages. We're told that Debra agrees to pay Paul $15,000 upon completion of his work. Therefore, Paul's expectation damages are $15,000, because that's what he expected to receive had the contract been fully performed. These damages were caused by Debra because she unjustifiably repudiated the contract, and they were both foreseeable and certain because they were the agreed-upon contract price.

Lee Burgess: Now, we still need to address the fourth requirement, which is that the damages be unavoidable. We're told that Paul secured a different job in the fifth week, which paid him $1,000 and took 10 hours to complete. So it seems that Paul did try to mitigate his damages, and Debra will argue that any damage award should be reduced by $1,000. Paul will successfully argue, however, that he could have completed both jobs at the same time. Debra's project only required 20 hours per week, and the smaller job required only 10 hours per week, for a combined total of 30 hours of work per week, well short of full-time work. Thus, Paul will likely be able to show that he is entitled to the full $15,000 in expectation damages.

Lee Burgess: Moving on, we're told that at the time of Debra's breach, Paul was negotiating with Tiffany to remodel her bathroom for $10,000, and that Tiffany stopped negotiation when she heard what happened between Debra and Paul. These are not expectation damages because they don't arise directly from the breach. These are consequential damages, or damages that arose indirectly from Debra's breach. In order to determine whether these consequential damages are recoverable, we need to apply our rule.

Lee Burgess: First, we need to determine whether these damages were reasonably foreseeable at the time of contract formation. Paul would argue that it is foreseeable that suddenly backing out of a contract would negatively impact the non-breaching party's reputation, thereby causing third parties to avoid doing business with them. Debra would argue, however, that while she repudiated the contract, she never alleged that Paul was doing a bad job. There are numerous reasons why someone might repudiate a remodeling contract that have no bearing on the other party's reputation, such as running out of money or deciding to sell the house. Thus, Debra would claim that it is not foreseeable that a third party would back out of a contract with Paul just because she repudiated their contract. You could go either way on this one.

Lee Burgess: The next thing we need to determine is whether Debra knew or should have known about Paul's circumstances. There is no indication that Paul told Debra about his negotiations with Tiffany or that Debra otherwise knew about the negotiations. On these facts, Debra likely had no reason to know that the success of the negotiations hinged on her following through on her agreement with Paul.

Lee Burgess: Finally, we need to determine whether the damages are certain. Paul would argue that but for Debra's breach, he would have secured a $10,000 contract with Tiffany, but that argument would likely fail. Paul and Tiffany were still in negotiations, and there is no way to know for sure whether they would reach a final agreement, and if so, on what terms. Therefore, Paul would likely not recover his consequential damages.

Lee Burgess:	That's it for our first hypo. Let's do one more that deals with slightly different issues:
Lee Burgess:	"On January 1, a painter and a bakery owner signed an agreement providing that the contractor would paint the owner's new bakery by February 1 for $10,000, paid upon completion.
Lee Burgess:	To celebrate the grand opening of the new bakery, the owner had planned and widely promoted a pie eating contest on February 15. The tickets to the contest were sold out, resulting in a profit of $4,000 for the owner. Prior to signing the contract with the painter, the owner told the painter that he was planning a grand opening celebration for February 15 that included a pie eating contest. He also told the painter that getting the bakery painted was the last step before he could open for business.
Lee Burgess:	On January 15, before starting the work, the painter unjustifiably repudiated the contract. The owner immediately began looking for another painter. Despite his best efforts, the owner could not find anyone to do the work by February 1. The owner was eventually able to find a painter that agreed to paint the bakery for $15,000 by March 1. No other painter could be found who would agree do the work at a lower price before March 1.
Lee Burgess:	The painting was completed on March 1, the substitute painter was paid $15,000, and the bakery opened a few days later. Because the bakery was still unpainted as of February 15, the owner canceled the pie eating contest and refunded all the ticket-holders. The owner could have moved the contest to a nearby community center, but he chose not to do so. Had he moved the contest, he would have made a profit of $2,000.
Lee Burgess:	The owner has sued the painter for, one, the $5,000 extra he paid the substitute painter; two, the $4,000 lost profit from the cancelled pie eating contest; and three, the profits he lost by remaining closed from February 15 to March 1. Can the owner recover these damages?"
Lee Burgess:	Now, as in our first hypo, we only need to focus on damages here. The first issue we've been asked to address is the $5,000 extra the owner paid the substitute painter. We're told that the original painter agreed to paint the bakery by February 1 for $10,000, and failed to do so. The owner could not find another painter to do the job by February 1, but he was able to find someone to do it by March 1 for $15,000. Therefore, the owner is $5,000 worse off than if the original painter had performed under the contract.

Lee Burgess: Now we just need to make sure these damages satisfy our rule for expectation damages. First, were these damages caused by the painter? Yes, because the owner would not have paid the additional $5,000 but for the painter's breach. Second, were the damages foreseeable? Yes, because it is foreseeable that the owner would hire a substitute painter and that the job could cost more, especially with the shorter turnaround time. Third, were the damages certain? Yes, because we know exactly how much the owner was supposed to pay the original painter and how much he actually paid the substitute painter. Fourth, were the damages unavoidable? Yes, because the owner went with the cheapest substitute performance he could find. Therefore, the owner is entitled to expectation damages in the amount of $5,000.

Lee Burgess: Okay, let's move on to our next issue, which is the $4,000 in lost profits from the cancelled pie eating contest. These are consequential damages because they don't result directly from the breach, but rather from the owner's special circumstances. Generally speaking, these damages would not be recoverable because a painter would not be able to foresee that a bakery could hold a pie eating contest right after opening. But we have some additional facts here that change the analysis. We're told that prior to entering the agreement, the owner told the painter that he was planning the grand opening of the bakery for February 15, and that the grand opening celebration would include a pie eating contest. He also told the painter that getting the bakery painted was the last step before he could open. Therefore, the loss of profits from the pie eating contest were reasonably foreseeable at contract formation, and arose from the owner's special circumstances that the painter was aware of.

Lee Burgess: The lost profits are also certain, because we know that the owner lost exactly $4,000 as a result of cancelling the contest. The tickets to the contest were already sold out, so the profits were neither speculative nor subject to change. Based on our rule, it looks like the owner is entitled to $4,000 in lost profits, right?

Lee Burgess: Not so fast. We still need to deal with mitigation. We're told that the owner could have moved the contest to a nearby community center, and had he done so, he would have made $2,000 in profit. The painter would argue that the owner should not be allowed to recover the full $4,000 because he could have avoided $2,000 of that loss by moving the contest. The owner will argue, however, that the purpose of the contest was to show off his new bakery. Moving the contest to another location would not serve that purpose. Therefore, holding the contest at the community center would not have been a reasonable substitute for a contest at the new bakery.

Lee Burgess: Now, we just have one more issue to address – the profits the owner lost from remaining closed from February 15 to March 1. We have already established that the painter had reason to know that the bakery was going to open on February 15 and that the painting was the last step before the bakery could open. Accordingly, it was reasonably foreseeable that the bakery would not be able to open on time if the painting wasn't completed on schedule. It was also foreseeable that the bakery would lose profits for every day it was forced to remain closed.

Lee Burgess: The real issue here is whether the profits were reasonably certain. How can we know the amount of profit the bakery would make between February 15 and March 1? The bakery is a brand new business, so the owner can't base his claim on a history of profits. While the owner probably has all kinds of forecasts, those are just speculation. The reality is that the bakery could be wildly successful in its first two weeks, or it could make no profit at all. There's simply no way to know for certain. Therefore, the owner will likely not be able to recover those speculative lost profits.

Lee Burgess: And that's all we have for you today. Hopefully you found these hypos to be helpful examples of how to work through expectation and consequential damages on an exam. If you enjoyed this episode of the Bar Exam Toolbox podcast, please take a second to leave a review and rating on your favorite listening app. We'd really appreciate it. And be sure to subscribe so you don't miss anything. If you have any questions or comments, please don't hesitate to reach out to myself or Alison at lee@barexamtoolbox.com or alison@barexamtoolbox.com. Or you can always contact us via our website contact form at BarExamToolbox.com. Thanks for listening, and we'll talk soon!

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