Chapter 10: Remedies

A. The Basic Standards:

1. The Coase Theorem shows that property rules have no allocative consequences if bargaining is costless and information is perfect. Of course, bargaining never is costless and information never is perfect, so property rules in fact have allocative effects. But what the Coase Theorem reminds us (and as Professor Coase explicitly recognized, see Ronald Coase, *The Problem of Social Cost*, 3 J. LAW & ECON. 1 (1960)) is that minimizing bargaining costs likely will improve allocative outcomes. Further, to the extent bargaining will be expensive, property rules likely will determine which activities are conducted.

Consider a railroad which runs adjacent to a farm. The farmer would like to grow wheat and the railroad would like to run a train. However, the train emits sparks that will cause the wheat to burn. Thus, either the farmer will grow wheat or the train will run, but not both. There are two possible property rules: (1) the farmer has the right to exclude the train, or (2) the train has the right to run without regard to the farmer's desires.

Suppose the train can install a spark arrestor at a cost of $100, and suppose further that the farmer can make a net profit of $125 from the wheat. If the farmer can exclude the train, he will do so and the wheat will grow. The railroad will be forced to purchase the spark arrestor, so it will make $100 less from running the train than it otherwise would make. If the farmer cannot exclude the train, he will agree to purchase a spark arrestor for the train, and again the wheat will grow. Note, though, that the farmer's net profit has decreased from $125 to $25 because of the need to pay for the spark arrestor, though the train's profit increases by the same amount. Note also that regardless of the property rule, the wheat is grown and the train uses a spark arrestor.

Suppose now that the farmer will only make a net profit of $80 from the wheat. If the farmer has the right to exclude the train, presumably the railroad will pay the farmer some amount between $80 and $100 for the right to run the train while emitting sparks. Thus, the train will run without a spark arrestor, no wheat will grow, and the farmer will be richer by something between $80 and $100. If the farmer cannot exclude the train, it will run without a spark arrestor, no wheat will grow, and the farmer will have no money. Again, the property rule does not affect the substantive outcome (i.e., whether wheat will grow; whether a spark arrestor will be used), but it *does* affect the relative wealth of the railroad and of the farmer. We say that the property rule in this case has no allocative effect (because it does not affect how society allocates its resources) but has a distributional effect (because it effects how society's wealth is distributed).

What does this tell us about damage rules in contract? First, like all other default rules, if the parties to a contract can bargain around them at low cost, they will do so when the default damage rules do not maximize their joint gains. Second, even if the parties fail to construct their own damage rule while negotiating the contract, they are free to renegotiate once a possibility for breach arises, with the original damage rule operating as the background property rule.

Note that contract default rules have even less significance than property rules: if bargaining is costless, contract default rules have no distributional or allocative effects. For example, suppose a seller of watches is not treated as including a warranty unless a warranty is expressly included. A seller who wishes to include a warranty will include one while a seller who does not wish to include a warranty will not include one. Conversely, if a warranty is presumed unless disclaimed, a seller who wants to offer a warranty will do nothing while a seller who does not want to include a warranty will include a disclaimer. That is, changing the default rule has no effect beyond forcing a change to the express terms of the offer.

When bargaining is expensive, property rules can have allocative consequences and contract default rules can have both allocative and distributive consequences. For example, reconsider the train/wheat examples above, but assume that the parties cannot contract without paying a contract tax of $35. Now, if the train can run without a spark arrestor it will do so (and there will be no wheat), even if the gains from growing wheat will more than cover the cost of a spark arrestor. Similarly, suppose that a default contract rule (for example, the mailbox rule providing (generally) that an acceptance is effective upon deposit in the mail) can only be modified by the contracting parties paying a contract tax. If two parties do not like the mailbox rule, but they dislike it only a little, they will live with it rather than pay the tax to change it.

Because bargaining costs generally increase as the number of contracting parties increases, default contract rules and property rules will be very important in transactions concerning large numbers of persons, especially when the effect on each person taken individually is small. Consider the case of driving an automobile. This activity threatens to a greater or lesser degree all pedestrians. Could you bargain with each pedestrian to permit you to drive? Certainly not: there are too many pedestrians and they are too diverse. Thus, if driving is to be allowed, we need some non-contract mechanism for compensating those who bear its costs. The tort system performs that role.

The example above of the farmer and the railroad assumes that if (1) the farmer has the right to exclude the train, and (2) the crop is worth only $80 while the spark arrestor costs $100, the farmer will sell his right to exclude the train for no less than $80 and no more than $100. Unfortunately, there is no way to guarantee this result. In particular, the parties may misrepresent their true preferences in a strategic attempt to obtain a larger share of the $20 surplus. And even if they do not misrepresent their preferences, they may be unable to reach an agreement because each side holds out for more than the other is willing to offer.

2. The Goals of Contract Remedies: Fuller and Perdue (cited in footnote 59, at page 99) identify three possible interests that can be protected: expectation, reliance, and restitution.

a. Identify the three interests.

b. Problem 7 (page 102): Expectation equals $55,000; reliance equals $45,000; and restitution equals $25,000.

c. In the first full paragraph on page 106, the textbook authors say: "[T]he parties can negotiate around any legal remedies." What does this mean? Consider the discussion on page 102 of the two alternate rules for contract damages: twenty times the price and 20% of the price. Could the contracting parties reach a welfare-maximizing result despite these rules by negotiating post-contract but pre-breach?

d. The discussion on the bottom of page 106 through page 108 assumes that the measure of damages for breach of contract is a default rule only (i.e., that the parties can negotiate around it if they desire). As we will see, that generally is not true.

3. Expectation Damages as a Substitute for Performance: The expectancy is the usual measure of damages. See Restatement of Contracts (Second) §347 (p. 47). Why? Note that if the nonbreaching party's expectation is fully protected, that party has no legitimate

grounds for complaint. Explain the issue in *Hawkins v. McGee*. Should the court protect the expectation or the reliance interest? Assume the price of the surgery was $10,000 with nothing paid in advance; value of the hand as promised equals $100,000 while value of the hand as delivered equals $25,000 and value of the hand before the operation equals $40,000. Should the plaintiff receive compensation for pain and suffering? If a second surgery can fully correct the damage and give the plaintiff what he bargained for, what should the plaintiff be awarded?

4. Measuring Expectancy: Cost of Completion or Diminution in Value

a. *Peevyhouse v. Garland Coal & Mining Co.* (p. 846): Essentially the same facts as *Groves*: cost of restoring the land would be about $29,000, while the value of the land as restored would be less than $5,000. *Held*, for the defendant, that cost of performance should be awarded only when it is not substantially in excess of diminution in value; i.e., if repair would not involve unreasonable economic waste. Here, the plaintiff specifically demanded the restoration clause and would not agree to the contract without it. Further, the land involved was the plaintiff's farm, not land zoned for heavy industrial use. Thus, there is substantial reason to believe that the land held special value for the plaintiff, and the court's holding fails to take that into account.

b. *American Standard, Inc. v. Schectman* (Note 1 at 852): The plaintiff shut down an iron plant and sold its improvements to the defendant in exchange for $275,000 and a promise to remove all foundations and similar structures to a depth of one foot so as to yield "a reasonably attractive vacant plot for resale." (See note 2 at 879.) The defendant did not remove the foundations below grade level because the cost of completion was $110,500. The plaintiff ultimately sold the land for $183,000 while the land as promised would have been worth $186,000. *Held*, for the plaintiff, because the breach was deliberate, even though there is no showing that the land had any value to the plaintiff beyond its objective market value. The court distinguished cases such as *Jacobs & Young v. Kent* by saying that waste means the tearing down of what has already been performed under the contract.

c. Note that the courts in both *American Standard* and *Peevyhouse* were attempting to protect the plaintiff's expectation interest. At issue was how we should measure the economic value of performance to the injured plaintiff. Awarding damages based only on market values risks undercompensating to the extent of the consumer surplus in the transaction (i.e., to the extent the property in question is worth more to the owner than its objective fair market value). If a jurisdiction follows the rule articulated in *American Standard,* will the defendant be inhibited from accepting other, profitable opportunities? The cost of completion under this rule is a sunk cost and so should not affect alternative decisions. However, since the defendant can *threaten to perform*, the parties likely will engage in expensive negotiation. Does the rule in *Peevyhouse* eliminate that negotiation? Is it a "fair" outcome? Why did the defendant in *American Standard* agree to remove foundations below grade?

d. Excluding transactions in which the evidence of consumer surplus is strong, most courts follow the *Peevyhouse* rule. See also RESTATEMENT OF CONTRACTS (2D) §348(2)(b).

5. Specific Performance

a. *Sedmak v. Charlie's Chevrolet, Inc.* (p. 857): The plaintiffs had contracted to purchase a limited edition corvette from the defendant for the manufacturer's suggested price. When the car was delivered, the value of the car had increased and the seller refused to deliver. *Held*, the buyer is entitled to specific performance because there is no reasonably obtainable substitute. What would the seller have had to pay if expectation damages had been awarded? Why did the seller refuse to perform, given that possibility? In what sense is the car "unique"? Will money damages not suffice to give the plaintiff his expectation? Is the issue one of consumer surplus (as in *Peevyhouse*) or something else? To get specific performance, must the plaintiff allege that he would have paid any amount of money (no matter how high) for the car?

b. *Van Wagner Adver. Corp. v. S&M Enters.* (p. 108): The plaintiff leased the side of a building in New York facing the Midtown Tunnel. The owner of the building sold the building, and the new owner cancelled the lease. The court determined that the lease was binding on the new owner and that the cancellation was a breach of contract. The plaintiff sued for specific performance, arguing (1) that the particular building was unique and (2) that the injury would be significant but very hard to calculate. The trial court only awarded expectation damages. *Held*, that the decision not to award specific performance was within the discretion of the trial court and was not erroneous.

c. *Klein v. Pepsico, Inc.* (Note 2 at 112): Universal Jet Service, Inc. ("UJS") contracted to purchase a G-II jet from Pepsico for resale to Klein. A contract for sale was agreed upon with a sale price of $4.6 million (with resale to Klein at $4.75 million), but Pepsico decided not to sell. Klein testified that he wanted the plane for resale and that he did not acquire a substitute G-II because there were very few available on the market. While the trial court awarded specific performance, the court of appeals reversed, saying: "[A]n increase in the cost of replacement does not merit the remedy of specific performance."

d. *American Brands, Inc. v. Playgirl, Inc.* (Note 4 at 862): American Brands, Inc. allegedly contracted in perpetuity to run its advertisement on the back cover of Playgirl magazine. Playgirl disagrees, and at issue is whether American Brands is entitled to a preliminary injunction pending trial. The court rejected both a positive injunction (forcing Playgirl to run the advertisement of American Brands) as well as a negative injunction (enjoining Playgirl from running any other advertisement) because American Brands could obtain reasonably similar substitutes. Does the court in *Davis v. Ziff Communications Company* (at 886) make a persuasive case for the opposite result?

e. Monetary Specific Performance (Note 2 at 859): The usual name for what is discussed in this note is "constructive trust." At issue is whether a breaching party should be able to profit from its own wrong-doing. Note that the court in *Bander v. Grossman* refuses to impose a constructive trust on the sale proceeds: in general, a party (here, the defendant) gambles with his own money. By refusing to impose a constructive trust on the defendant's sale proceeds, the court ensured that the plaintiff's recovery was independent of the eventual value of the property. If the plaintiff had the option to insist on a constructive trust, then it would have asked for the trust if the value of the property was sold by the defendant for a lot but would have asked for traditional expectation if the property had been sold for a little. A constructive trust rarely is awarded outside of breach of the duty of loyalty by a fiduciary. Note that because imposition of a constructive trust is treated as an equitable remedy, the plaintiff can elect to receive the usual legal remedy if the constructive trust yields a lower recovery.

f. Notes

i. In general, a plaintiff will recover on a contract theory only by proving (1) a contract, (2) a breach, and (3) injury resulting from the breach. To obtain an equitable remedy, the plaintiff must further prove (4) that legal remedies are inadequate, and (5) that the desired equitable remedy is appropriate.

ii. One common situation in which the equitable remedy of specific performance is awarded is to the purchaser of unique goods. Note, though, this is just one instance of the more general rule that *an equitable remedy can be awarded when money* *damages will not fully compensate the plaintiff*. See Restatement of Contracts (Second) §§359-360. Another common situation is when the plaintiff's injuries are substantial but uncertain. For example, suppose a seller refuses to deliver certain goods to be used by the buyer for resale to the government. If the breaching seller is not made to perform, the innocent buyer may lose its ability to compete for future government contracts. This would be a substantial loss, but not one compensable in money because of its uncertain amount.

iii. The requirement that the equitable remedy be appropriate encompasses both *a court's ability to frame the remedy* as well as the *court's ability and willingness to enforce the remedy with its contempt power*. For example, a court will not specifically enforce a promise to construct a building because it will not know how to order each nut and bolt to be installed, nor will it be willing to jail the builder if one wall is allegedly slightly out of place. The difficulties of administering equitable remedies probably explains the traditional hesitancy to order them.

iv. Courts are hesitant to order persons to work closely together. Thus, professional athletes who breach their contracts will not be ordered to play. Note that the monitoring burden imposed on the court would be extreme. However, courts often will issue negative injunctions, ordering the athlete not to play for a competitor. The thirteenth amendment is sometimes cited for the proposition that courts cannot specifically enforce promises by individuals to perform specific services, but in the context of enforcing voluntarily assumed obligations, that argument seems weak. Many courts say that a negative injunction should be issued only when the contract includes some express or implied exclusivity term. Courts also often limit negative injunctions to cases in which performance for someone else causes an additional harm to the plaintiff independent of the breach.

v. Professor Laycock at the University of Texas examined the remedies that courts are awarding, and he discovered that equitable remedies are awarded almost whenever they are requested. Thus, he concludes that the requirement that equitable remedies will be awarded only when legal remedies are inadequate has in large part been discarded. He may be correct, though it might also be the case that the rule is so well known, plaintiffs not entitled to an equitable remedy do not seek one. This is especially true if seeking an equitable remedy will have significant procedural implications, such as losing the right to a jury.

6. Reliance Damages

a. *Sullivan v. O'Connor* (p. 866): Plaintiff, an actress, sued her surgeon for failing in his claim to make her nose more attractive. To recover in tort, she must show some element of negligence, while contract only requires proving the promise (usually difficult, but here found) and a breach. Given the finding that the surgeon in fact promised that her nose would be more attractive after the surgery, what should the damages be? Expectancy would give her the difference between the nose as promised and the nose as delivered, as well as any costs (including pain and suffering) from the unanticipated third operation. In fact, though, the court gave her only her reliance damages. Note that this should include the costs (including pain and suffering) associated with *all three* operations as well as the worsening of her appearance. The surgeon wanted to refund only her payment to him; i.e., he wanted to pay only her restitutionary claim. Does payment of reliance damages fully compensate the plaintiff? In general, reliance fails to account for opportunity costs. Here, though, the possibility of lost opportunities caused by the surgery (other than by the worsening of her appearance; she can recover for that) seems remote. See the discussion in the carryover paragraph at the top of page 894. *Note that part of the reason the court rejects protection of the expectation is difficulty of measurement*.

b. *Kizas v. Webster* (p. 871): The FBI cancels a program intended to assist clerical employees to become agents; at issue is the proper measure of damages. Plaintiffs seek protection of the expectation ("Theory A") or the reliance ("Theory B"); the court awards reliance damages. This includes: (1) the difference between wages received from the FBI and average wages for a similarly-situated person from time of hiring until notified they should seek alternative employment; (2) costs of relocating to their FBI job (but not to relocating to their subsequent jobs – does this limitation make sense, especially if a plaintiff simply moves back to where he lived prior to the start of the program?). Costs related to spousal relocation were denied as the casual connection was too speculative. Note that the court seems willing to accept rough justice in the computation of reliance damages but not in the computation of expectation damages.

i. The FBI argues that the expectation can be computed and is zero. What is the argument? That full performance would at most give each plaintiff a job as an FBI agent, and because Agents are terminable at will, the expectation is zero. What is the court's response? See the paragraph starting at the bottom of page 872 carrying over to page 873.

ii. Note that a plaintiff will be given an expectation remedy unless computation of that remedy is too speculative. If the plaintiff signed a losing contract, reliance will offer a greater recovery than expectation. For example, suppose the contract price is $100,000 but the good is worth only $95,000 when seller breaches. Assuming the sale price was paid in advance, what amount compensates for the expectation? For the reliance? Note further that, in the case of a losing contract, expectation equals reliance less contract loss. In general, courts put the burden of proof on the defendant to prove expectation loss when the plaintiff proves reliance. See *L. Albert & Sons v. Armstrong Rubber Co*. (discussed in Note 3 at 876).

c. Costs Incurred Prior to Contracting

i. Hypo: Boxing promoter hires unknown Rocky Balboa to fight the heavyweight champion of the world, and pays Rocky $10,000 as a signing bonus. Promoter then rents a fight hall, putting down a deposit of $1,000. With this accomplished, Promoter signs the champion to fight Rocky, for the sum of $5,000,000. Promoter then begins advertising, and after $25,000 is spent, the champion repudiates the contract. What amount will protect Promoter's reliance interest? If Promoter goes to court to obtain a negative injunction, should the cost of that legal action be recoverable under a reliance theory?

ii. Problem (p. 877): Assuming that Anglia could have found another leading man and produced the play had Reed simply rejected the offer *ab initio*, all expenses (including those incurred prior to Reed accepting Anglia's offer) should be recoverable even under a reliance theory because they would have had value had there been no breach. That is, the prior expenses became worthless only because Anglia relied on Reed's promise to perform.

7. Restitution

a. *United States v. Zara Contracting Co.* (p. 878): Here, the nonbreaching plaintiff is suing off the contract for the value of work performed, where that amount would exceed its contract recovery rate. The court allowed such a recovery, in part on the theory that a unit price recovery would be unfair because the most difficult work already may have been performed. Many courts will now routinely allow quasi-contract recoveries in excess of the total contract price; many will not. One limitation generally applied, though, is that the contract price limits recovery if substantial performance has been rendered by the nonbreaching plaintiff. See Restatement of Contracts (Second) §373(2) and *United States v. Algernon Blair,* *Inc.* (cited in Note 1 at 884). How can this peculiar rule be explained? In the case of partial performance by a nonbreaching plaintiff against a breaching defendant, the value of the work performed must be determined because the contract, unless it is divisible, will not provide a figure. Because valuation cannot be avoided, there is no obvious reason not to award the value determined. But when performance is completed, the entire valuation step can be eliminated by awarding the contract price. Further, because this protects the plaintiff's expectation, it seems to be a fair resolution between the parties and minimizes the cost to society. Note that if this is the correct explanation then the defendant ought to be able to offer full payment even for part performance and thereby eliminate the damages phase of the trial.

b. *Britton v. Turner* (p. 881): Here, a breaching plaintiff who has not substantially performed is suing for a restitutionary recovery. The contract price was $120. Suppose the value of the work performed was $95, and that the cost to the defendant of hiring a comparable replacement for the remaining portion of the term was $40. What would be the appropriate recovery by the plaintiff? Only $80, because we must continue to protect the contractual expectation of the nonbreaching party. See the first two sentences of the final paragraph and *Palmer Const., Inc. v. Cal State Elec.* (cited in Note 1 at 884). How would the analysis go if the contract price of $120 had been prepaid?

8. Damages Under the U.C.C.

a. Seller's Remedies

i. In General: Under U.C.C. §2-703, the nonbreaching seller may withhold delivery, resell, and cancel the contract, and recover damages. Note there is a special rule for the repudiation of a contract to manufacture goods (U.C.C. §§2-703(c)), 2-704).

ii. Resale: When goods are resold in good faith and in a commercially reasonable manner, the seller may receive the excess of the contract price over the cover price. U.C.C. §2-706(1). This is the standard measure of expectation. If sold to a third party, the third-party buyer takes the goods free of any claim of the buyer, U.C.C. §2-706(5), and if the cover price exceeds the contract price, the Seller can retain the additional profit, U.C.C. §2-706(6).

iii. If the seller does not resell, then the seller can receive the excess of the contract price over the market price at the time and place for tender along with any incidental damages. U.C.C. §2-708(1). Incidental damages are defined in U.C.C. §2-710.

b. Buyer's Remedies

i. In General: The buyer can cover and receive expectation damages. U.C.C. §§2-711(a), 2-712.

ii. The buyer can obtain specific performance for specifically-identified goods. U.C.C. §2-711(2)(a).

iii. If the buyer does not cover, the buyer can recover the excess of the market price when the buyer learned of the breach and the contract price, as well as any incidental and consequential damages. U.C.C. §2-713.

iv. For goods accepted by the buyer and as to which notice of nonconformity has been given (see U.C.C. §2-714(3)), the buyer may receive the excess of the value of the goods as promised over the value of the goods as delivered. U.C.C. §2-714(2). Does the seller have a right to cure under U.C.C. §2-508 when a nonconforming tender is accepted? No. See Note 4 (p. 685).

c. *Carlson v. Rysavy* (p. 907): Defendants purchased a modular home based on viewing a model, and when it arrived it had significant defects and did not fully conform to the model. The buyers repeatedly asked the seller and the manufacturer for help in correcting the defects, but no help was forthcoming. *Held*, the notice required by U.C.C. §2-607(3)(a) need not identify every element of the subsequent claim. See comment 4 to U.C.C. §2–607. *Held further*, that cost of repair is relevant to determining damages but is not determinative. In particular, if some defects cannot be repaired, the buyer is entitled to damages for the diminution in value.

B. Limitations on Compensation

1. The Certainty Limitation

a. *Drews Company, Inc. v. Ledwith-Wolfe Associates, Inc.* (p. 915): Lost profits can be recovered even for the delay in starting a new business if they are proven with reasonable certainty. Here, they were not.

b. *Freund v. Washington Square Press, Inc.* (cited in Note 1 at p. 918): Washington Square Press agreed to pay Freund an advance when he submitted his manuscript for publication, and it did so. It also agreed to publish the book if it found it suitable. While Washington Square Press never rejected the manuscript as unsuitable, it also failed to publish the book. Freund claim that the breach (1) delayed his tenure and (2) cost him royalties, and he sued for the value of those claims as well as (3) the cost of publishing the book himself. The court found no such delay, said that the amount of any royalties was too speculative to award, and that the cost of publishing did not measure any injury but only the defendant's cost of performance, something to which Freund was not entitled. Assuming we wish to award the plaintiff his full expectancy, it seems we should award either items (1) and (2) or (3), but not both.

c. Problem (p. 920): Can the expectation be proved with certainty? If not, the appropriate remedy is Jenny's reliance. Note, though, that this remedy does not seem to account for Jenny's dog making it to the finals. Is it appropriate to award each finalist one-third of the grand prize?

2. Foreseeability

a. *Hadley v. Baxendale* (p. 116): What is the rule of this case? See pp. 116-17 ("Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things, from breach of contract itself, or such as may be 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."). To the extent this rule limits compensation, have we not undercut the rationale underlying the rule of the efficient breach. That is, if we do not award full compensation, a party's willingness to breach and pay damages may not be "efficient" in the sense that no one is injured by the breach (after receiving compensation) and at least one person is improved. Is there any way to justify the rule of *Hadley v. Baxendale*? Note that the rule of *Hadley v. Baxendale* forces a party with knowledge of special circumstances to disclose those circumstances to the other party or risk losing recovery for losses coming out of those circumstances. Thus, this rule is an *information providing* rule, maximizing the likelihood that the parties will come to an efficient bargain.

b. *Spang Industries v. Aetna Casualty & Surety Co.* (p. 921): Fort Pitt agreed to provide 240 tons of structural steel for a bridge to be erected by Torrington. After agreeing upon a delivery date, Fort Pitt missed the delivery by several months and then failed to tell its subcontractor when to show up to unload the steel. Because of the delay, Torrington incurred off-loading costs as well as over-time pay to pour the cement layer quickly, necessitated by the impending freeze. Torrington seeks these costs, but Fort Pitt argues that since the delivery date was not set until after the contract was formed, the freeze problem was unforeseen as of the time of contract formation. The court finds that Torrington reasonably mitigated its damages and so should be entitled to a full recovery.

c. Hypos:

i. You send a telegram in code to a ship at sea, telling the clerk that it is very important that the telegram gets there immediately. It is lost in transit, and so your goods are not picked up. Can you recover your lost profits? Would your answer change if the telegram was not in code, so that the clerk could read and understand its importance?

ii. An alarm company fails to respond timely to an alarm it monitors. Is the company responsible for the value of the goods taken? For the value of any pain and suffering received by residents who, but for the breach, would not have been injured? Is it relevant whether most people insure their goods even if they have an alarm? (No to this last question, although it might change the identity of the plaintiff from the resident to the insurance company.) Can the alarm company disclaim its liability for consequential damages? See Note 3 (p. 926) and Note 5 (p. 119).

3. Duty to Mitigate

a. Hypos:

i. Assume I have a contract to teach law at USD. Suppose the dean tells me that we have too many contracts professors, and so I must do janitorial work for my salary. If I decline the substitute offer, will I be able to collect my salary as damages? Is the question whether doing janitorial work is inferior to teaching law?

ii. The dean tells one of the janitorial staff that we have too many janitors but that we are short one Contracts professor. The dean offers to let the janitor teach contracts for his salary. If the janitor refuses the substitute employment, has the janitor failed to mitigate his damages?

b. *Rockingham County v. Luten Bridge Co.* (p. 929): The plaintiff agreed to construct a bridge for the defendant. During construction, the defendant repudiated, yet the plaintiff continued work on the building: *Held*, that the plaintiff had an obligation to mitigate its damages by stopping construction, so all that the plaintiff can recover is the costs incurred prior to the repudiation plus its expected profit from the contract as a whole. Note that saying there is a duty to mitigate does not mean one can be sued for a failure to mitigate but only that damages will be limited to what they would have been had they been mitigated. Note also that it was far from clear that the authorized representative of Rockingham County in fact repudiated. How should Luten Bridge Co. respond to such a ambiguous repudiation? Should it seek an answer from the county solicitor? What if no answer is forthcoming?

c. *Parker v. Twentieth Century-Fox Film Corp.* (p. 931):

i. In order to collect the contract wages of $750,000, what did Ms. Parker have to show? Nothing: the burden is on the breaching party to establish what (if anything) the nonbreaching worked could have, by reasonable efforts, earned from other employment ("other employment" that could not have been accepted but for the breach).

ii. Why was the other movie role "inferior"? Is the proper standard "inferior" or "dissimilar"? How should "dissimilar" be defined?

iii. If Ms. Parker had received unemployment compensation during the period when she was supposed to be under contract, would the amount of the unemployment insurance reduce the damages owed by Twentieth Century-Fox? Many courts have held that no offset is permitted, while some courts have gone the other way. This issue, the "collateral source" issue, arises in both contracts and tort whenever there is some insurance fund available to partially compensate the injured party. *Compare Billetter v. Posell*, 94 Cal. App.2d 858, 211 P.2d 621 (1949) (no offset) and *Hall v. Miller*, 143 Vt. 135, 465 A.2d

222 (1983) (same) *with United Protective Workers, Local No. 2. v. Ford Motor Company Co., 223 F.2d 49* (7th Cir. 1955) (offset allowed; full compensation requires no more).

d. Dealing with the Breaching Party (Note 1 at 936):

i. *Canadian Industrial Alcohol Co. v. Dunbar Molasses Co.*, 258 N.Y. 194 (1932): After breaching a contract to sell molasses at 4.75 per gallon, the breaching seller offered to deliver substitute molasses at 6.50 per gallon. At the time of this offer, the market price of equivalent molasses was about 7.50 per gallon. The seller wants damages to be limited to the difference between the contract price and its offered substitute price, but the court does not require the nonbreaching buyer to deal with the breaching seller in mitigation of its injury. *Held*, the buyer is entitled to the difference between the contract price and the *market price*.

ii. Suppose a head football coach at a major university is told that he is being replaced, but that he will become coach of the junior varsity. Can the fired coach reject the new position and still collect any salary remaining unpaid on his original contract? Suppose the college agrees to pay him in full. Does he have any potential grounds of complaint? Is he likely to win? See Restatement (Second) of Contracts §353.

4. Liquidated Damages

a. Hypos:

i. Suppose Buyer is interested in Blackacre, worth $100,000. Buyer pays Owner $1,000 for an option to acquire Blackacre anytime in the next 60 days for $100,000. If Buyer elects not to exercise the option, can Buyer recover any of the price paid for the option?

ii. Now suppose the price paid for the option was $30,000, and the contract price if the option was exercised was $71,000. Does that change the analysis? Note that in this case we know that most of the cost of the option (that is, most of the $30,000) is in fact a down payment on the purchase price. How do we know that? Because the value of the underlying property is $100,000 but the option exercise price is only $70,000. When should forfeiture of a deposit be allowed?

iii. In *Parker v. Twentieth Century-Fox Film Corp*, was the contract really an option contract or did it include a penalty clause? Is it fair to describe *Parker* as a case in which the damages were liquidated at full performance and the court's determination that no similar employment was offered is just another way of saying that the liquidation clause is a fair estimate of the plaintiff's loss?

b. RESTATEMENT (SECOND) OF CONTRACTS §356(1): **Liquidated Damages and Penalties**. Damages for breach by either party may be liquidated in the agreement but only at an amount that is reasonable in the light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss. A term fixing unreasonably large liquidated damages is unenforceable on grounds of public policy as a penalty.

c. U.C.C. § 2-718(1): **Liquidated or Limitation of Damages; Deposits.** Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty.

d. Note that saying a liquidated damages clause is unenforceable as a penalty is a conclusion rather than analysis. Explaining why the particular clause is a "penalty" is analysis.

e. *Wassenaar v. Towne Hotel* (1983): The plaintiff was the manager of the defendant's hotel working on a three-year contract, renewable at the employee's option. Less than a year into the contract term, the employee was terminated. The contract included a provision providing that if the employee was terminated, he would be paid for the full remaining term of the contract. A few months after termination, the employee found substitute employment. *Held*, that the liquidated damages clause is valid because any damages flowing from the employee's wrongful termination reasonable were anticipated to be hard to measure and the liquidated damage provision was a reasonable forecast of the harm caused by the breach. (Quaere: would Judge Posner agree with this latter point?) *Held further*, that once a liquidation damages clause is determined to be valid, the issue of mitigation disappears and the clause is enforced according to its terms without regard to actual or possible mitigation. Quaere: if a valid liquidated damages clause of an anticipated hard-to-value injury is invariably an estimate of the average possible loss, would not imposing mitigation turn an average into a ceiling?

f. *Lake River Corp. v. Carborundum Co.* (p. 941):

i. This court recognizes the traditional distinction between enforceable liquidated damages clauses and unenforceable penalty clauses. Under the traditional rule, a liquidated damages clause will be enforced only if (1) it was anticipated at the time of contract formation that damages would be difficult to estimate, and (2) the amount of the liquidated damages must have been a reasonable estimate of the likely damages flowing from breach or must be reasonable in light of the actual damages sustained. *See* RESTATEMENT OF CONTRACTS (2D) §356(1).

ii. The court held that the clause in question was a penalty because it operated to give more than actual damages: it did not reflect the costs saved by a breach. Because the liquidated damage was set equal to the unpaid price *without an allowance for saved expenses*, the liquidated damages amount would in all cases exceed the actual damages.

iii. The most common type of liquidated damages clause is one in which a single remedy is specified for all breaches, large or small. Such a blunderbuss clause regularly is stuck down as not being a reasonable attempt to forecast injury. For example, suppose a contractor agrees to redo your kitchen, and you insist that if the contractor is late, she must pay you $500 as a liquidated damages. This clause will not be enforced: the amount is fixed at $500, whether the contractor is late one day or one month. A clause providing for damages at a set rate per day is more likely to survive challenge.

iv. While Judge Posner invalidated the liquidated damages clause in this case (following state law), he forcefully stated the justifications for upholding them. At least as between sophisticated parties, there seems to be little reason for treating liquidated damages clauses different from other clauses in the contract.

g. *California & Hawaiian Sugar Co. v. Sun Ship, Inc.* (Discussed in Note 2 at p. 954)): The plaintiff paid the defendant to construct a custom-designed barge that would transport sugar from Hawaii to California, powered by a custom-designed tug. The contract included a liquidated damages clause of $17,000 per day for delay, and the defendant was very late in delivery. However, the tug also was unavailable so that no actual injury resulted from the defendant's delay, taken alone. The court found that the liquidated damages clause was valid because it represented a fair estimate of the damages the plaintiff was likely to suffer measured at the time the contract was formed and the parties reasonably believed that dames would be hard to measure. *Contra, Massman Const. Co. v. City Council of Greenville* (discussed in Note 2 at p. 954). Quaere: would damages really be hard to measure (the court in fact does not talk about this part of the test).

h. Suppose a liquidated damages clause is unenforceable under the traditional analysis. Can the plaintiff then recover more than the liquidated damages amount?

At least one court has held that the plaintiff *can* recover more. *Wilt v. Waterfield*, 273 S.W.2d 290 (Mo. 1954).