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**by: Colin E. Flora**
**Associate Civil Litigation Attorney**

# Damages Pt. 12 – Contract Damages

This week's post, brought to you by the attorneys at Pavlack Law, seeks to explain the various damages that can be recovered for the breach of a contract. Before jumping into the damages aspect it is important to realize that in a technical legal sense a contract is not a written piece of paper, but the promise upon that paper. In the most hyper-technical sense there is no such thing as a written or an oral contract. This is because at its basic level a contract is a promise that the law recognizes and finds to be enforceable. However, that is not to say that an oral agreement is functionally as likely to be enforced as a written agreement. Indeed, the advantage of the written and signed agreement is that it provides documented evidence of the contract. In fact, there are some contracts that the law requires to be written and signed. Nor is it to say that you will not hear lawyers using the terms oral and written contracts. Nevertheless, in order to understand some of the intricacies of contract damages you must understand that fundamental aspect of contract.

With that now clear let us turn out attention to the damages available to a person who has suffered harm from breach of contract. Under contract law there are five methods for calculating/awarding damages. These methods are: (1) expectation damages; (2) reliance damages; (3) restitution damages; (4) liquidated damages; and (5) specific performance. Recall from the first installment in the series on Damages that specific performance is a very rarely awarded and is generally the most powerful damage award in contract damages. In specific performance the court has

the power to order a person to take a specific action. This is almost always going to be to do precisely what he or she promised to do. This is a very extraordinary remedy because it far exceeds the typical realm of power exercised by a court of law, *id est* awarding money. The other four types of damages are in many ways much more interesting due to their complex natures.

### *Expectation Damages*

The gold standard for a breach of a contract is expectation damages. The Restatement 2nd of Contracts § 344 describes the interest in expectation damages as a person's "interest in having the benefit of his bargain being put in as good a position as he would have been in had the contract been performed." So what does this mean? Well let us probe into it a bit through examples.

Assume that you just got married, have a child on the way, and have decided that the motorcycle you purchased when you were in college needs to go. You happen to mention to your friend Jim that you are planning on buying an ad listing your motorcycle in the local newspaper. You tell Jim that you will list the price as $3,500 or best offer. Upon hearing this Jim says, "$3,500? I will give you $3,500 for the bike today and save you the $150 to run the ad." You agree, draw up the paper work, and have Jim sign it. Jim then leaves to go get the money. While walking home to get the money Jim saw a different motorcycle for sale and decided to buy that one instead. Jim then went back to you and said, "Sorry, I'm not going to buy the motorcycle." You reply, "But Jim, we have a contract?" Jim answers, "Too bad. I like this other bike a lot more – it's blue." With Jim having now breached the contract you post the ad in the newspaper. It turns out that the best offer you get is only $3,000. You, still livid at Jim and in need of money with the new baby on the way decide to sue Jim for breach of contract. The court finds Jim in breach and awards you expectation damages.

Now under that example, how much money does the court award you? Well first look back to the definition of expectation damages, "put in as good a position as he would have been in had the contract been performed." Under the contract with Jim you would have sold your motorcycle for $3,500. So does that mean that the breach should be $3,500? No it does not. The reason for which is quite simple – you still have the motorcycle. The original contract was based on the exchange of the motorcycle for money. So you were going to give something up. Since you were going to give something up that means you were not going to realize all of that $3,500. You were only going to realize $3,500 minus the actual value of the motorcycle. So what is the actual value of the motorcycle? Well that can be determined by the amount for which you were ultimately able to sell the bike – $3,000. So we now know that the difference between the amount Jim agreed to pay for the bike and the

amount for which you were able to sell it is $500. So does that mean that the judge awarded you $500? Close, but there is still something missing. Recall that had you sold the bike to Jim you would never have had to run the $150 ad in the newspaper. This means that you had to incur an additional $150. Thus, to receive the full expectation damages you would recover $650.

Of course since the law and life is almost never this easy and clear let us consider a few changes to this example to illustrate a few other interesting aspects of the law on expectation damages. What would the damages under the same fact pattern be if you had agreed to sell the bike to Jim for only $3,000 and after he backed out on the deal you found a buyer who would pay $3,400? We saw above how to calculate the damages so let us plug the new numbers into what we did there. There we said the amount Jim agreed to pay (here $3,000) minus the amount the bike sold for (here $3,400) plus the cost of the ad (still $150) was equal to the amount awarded. In this example if you do the arithmetic you will realize that you are better off that Jim backed out on the deal. Thus you are in a better place than had Jim not backed out. Therefore you are not entitled to any damages. While this does not mean that Jim did not breach the contract – he most certainly did, trust me I wrote the example. However, just because he breached the contract does not mean that you can recover any money from him for breaching.

Now if that is clear, let us try to muddy the waters yet again. Lets go back to the original example. You have just signed the contract with Jim for him to buy you bike for $3,500 and he leaves. After he leaves you have a change of heart and decide to not sell your motorcycle. Meanwhile, once Jim gets home, he calls up his cousin and enters into a contract to sell the motorcycle to his cousin for $4,000. Jim grabs $3,500 and heads back to you with cash and hand thinking about the easy $500 he had just made. Then you bring his world crashing down by telling him that you aren't going to sell the bike. So Jim sues you for breach of contract and asks for the judge to award him the $500 that he was going to make by selling the bike to his cousin. Under this example there is an interesting limitation on expectation damages that comes into play. Under Indiana law, "damages claimed for a breach of contract must be the natural, foreseeable, and proximate consequence of the breach." The way this plays into this example is because you had no idea that Jim had planned to resell the motorcycle to his cousin. Thus, it is possible that the injury suffered by Jim was not "foreseeable" and therefore not recoverable.

One last change to the example; assume that instead of this being the only motorcycle that you own, you run a motorcycle lot and that instead of this being some old bike it's the newest model out there and you can order as many of them as you want. Further assume that Jim agreed to buy it for $3,500 and that they cost you $2,500 to buy from the manufacturer. After Jim refuses to buy the bike that he

contracted to buy someone else buys it for the same price Jim agreed to pay. Now, based on everything else that you have read above you are probably quite confident that you are not entitled to any money under this example. If this is your conclusion then you overlooked one major change. Under this example you have an unlimited supply of motorcycles to sell. This means that if Jim had not backed out of the deal you still would have sold a motorcycle to the person who ultimately bought the bike. Thus, you have suffered the loss of an opportunity to sell a bike. In this scenario the breach by Jim stands alone. Your damages are what Jim agreed to pay ($3,500) minus the cost to you for the bike ($2,500), which equals $1,000.

### *Reliance Damages*

Reliance damages are much more rare in breach of contract cases. They are generally more well suited for promissory estoppel cases. These are cases in which the law recognizes that a person has been injured by relying on the promise of another but for certain reasons the promise did not form a contract. Reliance damages are meant to reimburse a person for his or her losses caused by reliance upon the promise and to put the person in the same position he or she would have been in but for the reliance on the promise.

This is very easy to illustrate by example. Assume that Fred has a job making $75,000 a year working at company A. Fred is told by his buddy John who owns company B that if he will leave company A he can have a job at company B for $100,000 a year. Fred, wanting to increase his salary, leaves his job at company A and tells John that he is ready to take his job at company B. When he does, John replies, "Oh, sorry Fred we aren't going to be able to give you that job after all." Fred, unable to get his job back at A has to take a $50,000 job at company C. Fred would have been making $100,000 a year but now is left making only $50,000 a year. Under expectation damages, Fred would be entitled to seek $50,000 a year in damages from John. However, under reliance damages Fred is not entitled to seek that amount. What he can seek is the difference between the position he was in before the promise and the position in which he is left after his reliance. Before the promise he was making $75,000 and after his reliance he was left making only $50,000. Thus, he can only seek $25,000 per year in damages.

The chief difference between reliance damages and expectation damages is usually under expectation damages a person has an enforceable contract that has been breached. Whereas under reliance damages there is only a promise from which the law has been willing to recognize that some injury has occurred but is not itself an enforceable contract. Note, however, that it is possible to bring a claim for reliance damages even where there is an enforceable contract. The reason for doing so may be dictated by strategy and the specifics of the circumstances which are too

numerous to enumerate here.

### *Restitution Damages*

The fourth type of damages are restitution damages. This described as restoring the injured party to the position in which he was before he conferred a benefit on the other party. Like reliance damages, restitution damages are available in breach of contract cases but are more widely used in cases that are similar to breach of contract but are not contracts. Restitution damages are usually sought in claims for unjust enrichment/quasi-contract. These cases are ones in which a person has conferred a benefit on another and due to the circumstances it would be unjust for the person to keep the benefit without paying.

An example; your neighbor contracts for painters to paint his home while he is out of town. Your home, across the street, is equally in need of repainting. One day while you are sitting in your living room watching movies, you see a painting crew outside repainting your house. You know you did not order a paint crew but decide not to say anything. In fact, what happened is that the crew got the wrong address and painted the wrong house. Of course, the painting company wants you to pay their usual fee of $2,500 ($1,000 in paint and $1,500 in labor) to paint a house. You, on the other hand, claim you should not have to pay for anything since you did not ask them to paint your house. If this case went to trial a court may well order you to pay restitution damages to the painters. There are two ways a court may try and determine what that amount is. Since restitution is measured in the benefit conferred the value is the result of the paint upon the house. You do not have the long-term benefit of the $1,500 in labor after the painters leave. Nevertheless, you do have the value of the paint that is now on the side of your home. So, one way to measure the value conferred upon you is the cost of the paint. Another way is to measure the increased value of your property. That is, compare the value of your home without the paint to the value of your home painted.

### *Liquidated Damages*

This may be the type of damages with which most readers are familiar, whether they realize it or not. Liquidated damages are the damages that you agree to pay by the terms of the contract for certain actions. Anyone who has ever rented a piece of property has likely encountered the concept of liquidated damages. If you have read in a lease where it states that if you breach this lease you will owe the renter X number of dollars, then you have encountered a liquidated damages clause.

There are great advantages to liquidated damages in so much as a breaching party knows the cost of breaching and the court can easily calculate those damages.

However, a fundamental concept of contract law is to not punish breach. That is to say, the law recognizes that there are economic benefits to all of society if a party can breach a contract and pay damages that are not a penalty for the breach. Basically, what this means is that a liquidated damages provision should attempt to approximate the expectation damages and where it acts to go above and beyond that it should not be enforceable. The rationale behind this is that if the liquidated damages go beyond the expectation damages then the purpose of the liquidated damages is to punish a party for breaching and that hurts society as a whole.

The Supreme Court of Indiana recently summarized Indiana law on this topic in *Time Warner Entertainment Company, L.P. v. Whiteman.*

> "In determining whether a stipulated sum payable on a breach of contract constitutes liquidated damages or a penalty, the facts, the intention of the parties and the reasonableness of the stipulation under the circumstances of the case are all to be considered." If the sum sought by a liquidated damages clause is grossly disproportionate to the loss that may result from a breach of contract, we should treat the sum as a penalty rather than liquidated damages. "Liquidated damages provisions are generally enforceable where the nature of the agreement is such that when a breach occurs the resulting damages would be uncertain and difficult to ascertain." However, to be enforceable the stipulated sum must fairly be allowed as compensation for the breach. Additionally, we construe any contract ambiguity against the party who drafted it. If there is uncertainty as to the meaning of a liquidated damages clause, classification as a penalty is favored.

Needless to say, the way to calculate damages can be extremely complex and dictated by the circumstances. For this reason it is extremely important to utilize the services of an attorney that is experienced, understands this complexities, and knows Indiana law.

Join us again next week.

- Pt. 1 – Introduction to Damages and Loss of Consortium
- Pt. 2 – Duty to Mitigate Damages
- Pt. 3 – Diminished Value of Vehicle Due to Traffic Accident
- Pt. 4 – Damages for Negligently Inflicted Emotional Distress
- Pt. 5 – Assessing Damages When Injured Person is Partially at Fault
- Pt. 6 – Availability of Prejudgment Interest
- Pt. 7 – Indiana Crime Victim's Relief Act

- Pt. 8 – Ability to Recover by Piercing the Corporate Veil
- Pt. 9 – Damages for the Loss of Chance of Survival from Medical Malpractice
- Pt. 10 – Punitive Damages Under Indiana Law
- Pt. 11 – Wrongful Death

## Sources


- *Lincoln Nat. Life Ins. Co. v. NCR Corp.*, 603 F. Supp. 1393, 1405 (N.D. Ind. 1984) (quoting Restatement (second) Contracts § 344).

- *Masonic Temple Ass'n v. Ind. Farmers Mutual*, 837 N.E.2d 1032, 1037 (Ind. 2005).

- *Time Warner Entm't Co. v. Whiteman*, 802 N.E.2d 886, 894 (Ind. 2004).


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