Anglo-American Contract and Torts

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23. Contract remedies

The exam will be open book. You may use whatever materials you want, including the book, a copy of my slides, your notes, and a dictionary.

How US law students generally are taught to think about contract remedies

"The theory of efficient breach"

also known as

"The option theory of contract"

There is no obligation to perform a contract. Rather there is an option—a choice—either to perform or to pay damages.

What led to this curious way of thinking . . .

The proposition is true. As a legal matter, if one breaks a contract, then the usual consequence is an obligation to pay damages.

Oliver Wendell Holmes, Jr. and the “bad man theory of law.” Holmes told entering law students it is useful to think of the law from the perspective of a bad man who wants to know the practical consequences of breaking the law. Holmes used contract to make his point.

“The Path of the Law,” 10 Harv. L. Rev. 457 (1897)

In the same speech Holmes argued for “the prediction theory of law.” A statement of law is a prediction of what a judge will do.

The theory of efficient breach does accurately describe (or fit) some features of contract law.

The usual measure of damages is "expectation damages," which compensate the promisee for its loss from non-performance.

The standard account is that this damage rule encourages "efficient breach" when resources can profitably be shifted from performance of a contract to other uses.

Posner, Economic Analysis of Law

Contract price for widgets = 10 cents
Value to buyer at time of performance = 14 cents
Value to seller at time of performance (what a 3rd party will pay) = 15 cents

The expectation measure properly encourages seller to breach for it nets a 1 cent profit per widget after paying the disappointed buyer 4 cents damages per widget (or 14 cents if the buyer prepaid).

The foreseeability limitation

Hadley v. Baxendale, Text185. Contract to carry broken mill shaft to be repaired. Carrier delayed in shipping so mill could not operate. Held mill's lost profits are not recover.

The rule in *Hadley* is stated at Text 185 (middle):

> "damages . . . should be such as may fairly and reasonably be considered either as arising naturally, i.e. according to the usual course of things, from such breach of contract itself, or such as may reasonably supposed to have been in contemplation of both parties . . . as the probable result of breach."

The *Hadley* rule is a gap-filler or background rule. It defines the scope of a party's liability for breach in the absence of an express term.

> "Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable." Uniform Commercial Code 2-719(3)

> "Subsection (3) recognizes the validity of clauses limiting or excluding consequential damages . . . . Actually such terms are merely an allocation of unknown or undeterminable risks." Comment 3.

The *Hadley* rule may appear similar to the general rule on scope of liability (legal cause) in negligence law, which also is couched in terms of foreseeability.

Foreseeability is determined under the *Hadley* rule at the time the contract is made, not the time of breach.

Lord Reid gives some familiar reasons for this at the bottom of Text 188 and top of Text 189.

In asking what was foreseeable, assume the breach is anticipated. The question is what loss would be foreseeable at the time of contract anticipating the breach. See 2nd paragraph from bottom Text 188.

In *Koufos* the shipper agreed it was liable for interest lost as a result of the delay in turning sugar into cash. Had it been carrying equipment it would be liable for the normal rental value of the equipment on the same principle.

The issue in the case is whether the shipper is liable for a loss due to the drop in the price of sugar between the date the vessel ought to have arrived and the date it did arrive. The shipper was held liable for this loss under the *Hadley* rule.

Shipper's routinely limit their liability for consequential losses, including lost use value.

Some other reasons damages are inadequate:

- A damage award is a judgment debt that must be collected through further proceedings and is dischargeable in bankruptcy.

- Legal proceedings are costly, particularly under the "American rule" in which the victor is not awarded costs.

- Damages are not awarded for speculative economic losses and non-economic losses.

Requisite degree of certainty

"Damages are not recoverable for loss beyond an amount that the evidence permits to be established with reasonable certainty." Restatement Second § 352.

If a breach causes a speculative venture to fail, then the venturer will not recover its potential lost profits under this rule. It will recover its wasted costs under the heading of "reliance damages."

US courts differ enormously on how much uncertainty is tolerated in submitting damages to the jury.

"Where the amount of damages cannot be established with a sufficient degree of certainty, the assessment is at the discretion of the court." Unidroit Art. 7.4.3 (3).

Law as distinct from Equity

Separate courts until 19th and early 20th century, when law and equity were merged.

There remain separate equity courts in a few states, most importantly Delaware. Delaware Corporate law is administered by the Chancellor.

Estoppel comes from equity (thus equitable estoppel).

The remedy of an injunction comes from equity.

In most states in which law and equity are merged, issues of fact and "mixed issues of fact and law" are resolved by the court, and not the jury, if a claim or defense is equitable in nature.

Requirements for an injunction, in addition to establishing a legal injury.

The injury must be irreparable, meaning the legal remedy of a damage award must be inadequate to rectify the injury (in contract to put the plaintiff in the promised position).

Civil law starts from the opposite starting position. There is a right to specific performance unless there are good reasons not to compel performance.

An injunction is a court order.

The order can be negative ("do not do *x*") or positive ("do *x*")

If a defendant refuses to obey an injunction, a court may use coercive sanctions—fines and imprisonment –to compel obedience in the future. Past non-obedience is a basis for criminal contempt (usually a misdemeanor) or civil damages.

A damage award is a debt owed by the defendant to the plaintiff. The debt is dischargeable in bankruptcy. The only sanction for delay in payment is an interest charge.

Some discretionary factors to be considered in granting an injunction:

- Administrability/judicial capacity
- Feasibility of performance
- Undue burden (aka “balance of hardships”)
- Indefiniteness of obligation to be performed
- Public interest

Courts routinely will compel performance of a contract to sell land so long as the vendor has title.

Damages for the additional cost of buying substitute land were considered to be inadequate historically because land was thought to be unique.

Also favoring specific relief . . .

- Administrability/judicial capacity
- Feasibility of performance

A court never will affirmatively compel an individual to perform a personal service contract.

Traditionally neither would courts compel an employer to re-hire an employee who has been wrongfully fired. This rule is changing. Reinstatement is routinely ordered as a remedy for employment discrimination.

Courts will enforce a negative covenant by an employee not to work for a competitor, which brings us to . . .

Warner Bros. v. Nelson (1936), Text 191

Bette Davis (Nelson) fled the US and went to England to try to escape contract with Warner Bros. that gave the studio control over her acting career potentially for her entire career. Stars were tied to one year contracts that the studio had the option to renew perpetually.

The Studio brought this lawsuit in England seeking a negative injunction to bar Davis from acting in film or theatre in England.

A producer who hired Davis in violation of the injunction would expose himself to contempt proceedings as well as liability for damages.

Davis argued the contract tying her to the studio was an illegal restraint on trade. The court responds no since she was prohibited from acting for others only while she was employed by the studio. See p. 192 top.

There are common law restrictions on restricting an employee's right to work for a competitor after their term of employment. Indeed, such restrictions are illegal in California. An employee may be prevented from working for a competitor only to protect trade secrets.

Davis sought relief on various discretionary factors. The court's answer at the bottom of p. 192 is striking. A court has no discretion to deny a request for a negative injunction to enforce a clearly agreed to "negative covenant." This clearly is not the law in the US.

Davis argued that by granting the injunction the court was doing indirectly what is conceded it could not do directly . . . forcing her to return to work for the studio. The court basically says tough.

Lumley v. Wagner, a 19th century case, which is repeatedly cited by the court, is similar. Wagner is Richard Wagner's niece.

At the bottom of p. 194 the court explains why the legal remedy—damages—is inadequate in a case such as this. This is uncontroversial for the loss is difficult to measure.

The court throws Davis some sops at the end of the opinion, p. 195. The order will run only to areas within the court's jurisdiction.

And the injunction will run no longer than three years and it will end sooner if the studio terminates the contract.

The three year restriction is curious for the studio had the power to extend the contract perpetually. This follows from a principle not otherwise discussed by the court. The injunction may be enforced only to protect the employer from competitive harm and not from the harm from the loss of the employee's services.

Davis went back to work for Warner Bros. where her career flourished.

Several years later Olivia De Havilland successfully challenged the studio’s contract under a California statute restricting exclusive employment agreements to a period of seven years.