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DAMAGES for Breach of Contract

Measurement and Limitations

Tort lawsuits get more attention in the press, but contract lawsuits outnumber tort lawsuits in most state courts. In turn, the most important aspect of most contract lawsuits is the determination of damages. Few lawsuits are undertaken merely for a declaration of rights or to recover nominal damages. Yet, comparatively little has been written on the topic of contract damages. Thus, the purpose of this article is to summarize the legal principles recognized by Michigan courts as governing the measurement of, and limitations on, damages for breach of contract.

Measures of Recovery

The Expectation Measure

In a typical contract, one party has a duty to perform (construct a building, deliver goods, convey real estate) and the other party has a duty to pay money. Breach by the performer may take the form of nonperformance, defective performance, or delay in performance. The primary purpose of damages for breach of a contract is to protect the promisee's expectation interest in the promisor's performance. Damages should put the plaintiff in as good a position as if the defendant had fully performed as required by the contract.

In cases involving a failure to perform, the plaintiff's expectation interest is measured by

difference-money damages. Thus, the general measure of damages for failing to perform a construction contract is the difference between the contract price and the cost of construction by another builder. Damages for failing to deliver goods are measured by the difference between the contract price and the market value of the goods (or the cost of cover). Damages for failing to perform a real estate sale contract also are measured by the difference between the contract price and market value.

In cases involving defective performance, the plaintiff's expectation interest may be measured in one of two ways: the cost of repair or the diminution in value. In construction contracts, for example, damages for defective or incomplete construction generally

are measured by the cost of repair or completion. In contracts for the sale of goods, on the other hand, damages for nonconformity with the contract generally are measured by the diminution in value of the defective goods. The purpose of both measures is to place the plaintiff in as good a position as if the defendant had performed the contract according to its specifications.

If the performance of a contract is merely delayed, the plaintiff may seek delay damages to protect his or her expectation interest. These damages generally are measured by the value of the use of the contract's subject (building, goods, land) that was lost during the period of delay. Use value commonly is measured by the subject's rental value. If the subject of the contract has no ascertainable rental value, delay damages may be measured by interest on the subject's market value during the period of delay. Similarly, if the delay is in the payment of money, delay damages are measured by interest on the sum due.

The Reliance Measure

If expectation damages are unavailable due to the limitations of certainty, foreseeability, or mitigation (discussed below) the promisee may measure damages by the reliance interest. The purpose of measuring damages by the reliance interest is to put the plaintiff in as good a position as if the contract had not been made, by compensating

for losses caused by the plaintiff's reliance on the contract. Examples follow:

- A store owner whose commission sales contract is breached may recover the cost of altering the store to receive the defendant's goods and of selling the old stock on hand at a loss, as well as the other costs of preparing to act as the defendant's retail agent.
- One who breaches an option contract may be held liable for expenditures made and time spent by the plaintiff in attempting to perform the option.
- A sand-and-gravel contractor who is unable to prove lost profits resulting from the defendant's anticipatory repudiation of a supply contract may recover reliance damages based on reasonable expenses incurred in attempting to perform the contract.

The plaintiff may not recover both expectation and reliance damages if the recovery would put the plaintiff in a better position than if the contract had been performed. For example, if a supplier breaches a sales agency contract, the plaintiff may not recover both commissions on lost sales and costs incurred in advertising the merchandise for sale.

Expenses incurred before entering into a contract are not recoverable if they were not contemplated by the parties when they made the contract. Nor may the plaintiff continue to incur reliance expenses after learning of the breach.

The Restitution Measure

In some situations the promisee may seek compensation for the restitution interest in order to recover a benefit conferred upon the other party. Restitution commonly is sought in rescission cases. For example, a land contract buyer who discovers defects in the vendor's title may elect to rescind the contract and seek restitution of the payments made rather than to recover damages measured by the reduction in value of the property.

Restitution as a measure of recovery for breach of a contract is not limited to cases involving rescission, however. More generally, the restitution measure permits recovery based on the value of the plaintiff's performance under the contract, rather than the loss sustained as a result of the defendant's breach.

Fast Facts:

Damages should put the plaintiff in as good a position as if the defendant had fully performed as required by the contract.

Expenses incurred before entering into a contract are not recoverable if they were not contemplated by the parties when they made the contract.

Damages for lost profits must be based on net profits, not gross profits.

In an early Michigan case, in which the defendant's breach prevented the completion of a contract, the plaintiff's restitution option was described as follows:

The general rule is well settled that a party to a contract where labor is to be performed, upon the breach of that contract by the other party, has two remedies open to him. He may sue upon the contract, and recover damages for its breach, or he may ignore the contract, and sue for services and labor expended, and expenses incurred, from which he has derived no benefit. In case he pursues the latter remedy, the measure of damages as to services is not necessarily the contract price, even though the value of the services can be measured or apportioned by the contract rate; but he may recover what his services are reasonably worth, although in excess of the rate fixed by the contract.

Because restitution is based on the benefit conferred on the defendant by the plaintiff's performance, restitution is measured by quantum meruit (the reasonable value of services rendered) rather than the contract price (as in expectation damages) or the plaintiff's costs (as in reliance damages).

Limitations on Recovery

The Certainty Limitation

Although damages need not be mathematically precise, they may not be based on mere speculation. The evidence need only provide a reasonable basis for computing damages, which may be approximate. If the existence of some damages has been estab-

lished, the defendant bears the risk of uncertainty about the amount of damages.

The certainty limitation is often raised as a defense to a claim for lost profits. The general rules regarding certainty apply to claims for lost profits. Thus, doubts about the certainty of lost profits are to be resolved against the breaching party rather than the injured party. Lost future profits may be established by profits made in past years. The lack of a record of profitability has led many jurisdictions to deny new businesses any recovery for lost profits, but Michigan has rejected the new business/interrupted business distinction. The leading case is *Fera v Village Plaza, Inc* (1976).

Damages for lost profits must be based on net profits, not gross profits. Failing to define the term *lost profits* in jury instructions, and to distinguish between gross profits and net profits, is reversible error.

The Foreseeability Limitation

The foreseeability limitation has its roots in the landmark decision of *Hadley v Baxendale* (1854), in which an English court established the following rule for recovering damages in contract cases:

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 such 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.

The decision in *Hadley v Baxendale* actually established two rules. The first *Hadley* rule limits contract damages to those generally available to protect the prevailing party's expectation interest, as described above. The second *Hadley* rule permits recovery of additional damages based on the special circumstances of a particular case, if the special circumstances were within the contemplation of the parties when the contract was made.

Recent cases involving the foreseeability limitation have clustered around the recoverability of lost profits and damages for mental distress. In regard to claims for lost profits, it is important to distinguish between profits lost directly from the nonperformance of a

before and after *Kewin*, Michigan courts have barred recovery of mental distress damages in actions for breach of an employment contract. Likewise, construction contracts have been held to be commercial contracts; thus, mental distress damages are not recoverable for breach of a construction contract unless these damages are proved to have been within the contemplation of the parties when the contract was made.

The *Kewin* court recognized certain exceptions to the general rule denying mental distress damages for breach of contract. One example is breach of an agreement to deliver the plaintiff's child by Cesarean section, resulting in the child being stillborn. An agreement to perform a tubal ligation was held to be "intensely personal in nature." Thus, a damages award for mental anguish was ap-

tiff to mitigate the "damage" of the unwanted pregnancy by undergoing an abortion or putting the child up for adoption.

- In a case involving a sales agency contract, plaintiff was not required to use another manufacturer to complete a contract because it would take three to five years to complete the contract, and the additional spending would not be recouped until years later.
- In an employment case, the court held that the plaintiff need not have accepted work that was part-time, at lower wages, of undetermined tenure, or that had fewer supervisory duties.

Failure to mitigate damages is an affirmative defense. Thus, while the plaintiff has the duty to mitigate damages, it is the defendant

Reasonable expenses incurred in an effort to mitigate damages, even if the effort is unsuccessful, are recoverable as damages.

contract and profits lost in a collateral transaction. To recover lost profits when the defendant's breach of contract prevents the plaintiff from profiting from a collateral transaction, the plaintiff must show that the parties contemplated the plaintiff's entry into the collateral transaction. Only if the defendant was aware of the plaintiff's collateral enterprise when the contract was made would those lost profits be recoverable.

In *Kewin v Massachusetts Mut Life Ins Co* (1980), the Michigan Supreme Court reaffirmed the view that under *Hadley v Baxendale* damages in commercial contract cases are limited to the monetary value of the breaching party's performance and cannot include damages for mental distress. The court held that a disability insurance policy was such a commercial contract. Therefore, an insurer's breach does not give rise to a right to recover compensation for mental distress, absent proof that mental distress was within the contemplation of the parties when the contract was made.

The courts have used the *Kewin* decision to deny mental distress damages for breaches of other forms of insurance contracts. Both

appropriate because the failure to perform the contract could foreseeably cause great mental pain and suffering. Another example of a contract held to be personal rather than commercial is a contract for the care and burial of a deceased person's body. Another is a contract for child care, where it was recognized as foreseeable that a breach would cause mental distress to the parents.

The Mitigation Limitation

The Michigan Supreme Court has described the duty to mitigate as follows:

Where one person has committed a tort, breach of contract, or other legal wrong against another, it is incumbent upon the latter to use such means as are reasonable under the circumstances to avoid or minimize the damages. The person wronged cannot recover for any item of damage which could thus have been avoided.

The critical word that defines the duty to mitigate is *reasonable*.

- In a medical breach-of-contract case for an ineffectively-performed sterilization procedure, the court held that it was not reasonable to expect plain-

who has the burden of proving the plaintiff's failure to mitigate. If the defendant does not plead and prove a failure to mitigate and, further, does not request a jury instruction on mitigation, the defendant may not argue in closing that the plaintiff failed to mitigate. Moreover, if there is evidence that the plaintiff did comply with the duty to mitigate and no evidence that the plaintiff failed in this duty, a jury instruction on mitigation is not proper.

Here's a final tip: Although the doctrine of mitigation generally is thought of as a "negative" rule that limits damages, it has an "affirmative" side as well. Reasonable expenses incurred in an effort to mitigate damages, even if the effort is unsuccessful, are recoverable as damages. Such mitigation expenses should be regarded as special damages for purposes of pleading and proof. ◆

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