

8th Edition

Fundamentals of Business Law: Summarized Cases

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Library of Congress Control Number: 2008939882

ISBN-13: 978-0-324-59573-4
ISBN-10: 0-324-59573-5

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CHAPTER 12

Breach and Remedies

LEARNING OBJECTIVES

AFTER READING THIS CHAPTER, YOU SHOULD BE ABLE TO ANSWER THE FOLLOWING QUESTIONS:

- 1 What is the difference between compensatory damages and consequential damages? What are nominal damages, and when do courts award nominal damages?
- 2 What is the standard measure of compensatory damages when a contract is breached? How are damages computed differently in construction contracts?
- 3 Under what circumstances is the remedy of rescission and restitution available?
- 4 When do courts grant specific performance as a remedy?
- 5 What is the rationale underlying the doctrine of election of remedies?

As the Athenian political leader Solon instructed centuries ago, a contract will not be broken so long as “it is to the advantage of both” parties to fulfill their contractual obligations. Normally, a person enters into a contract with another to secure an advantage. When it is no longer advantageous for a party to fulfill her or his contractual obligations, that party may breach the contract. As noted in Chapter 11, a *breach of contract* occurs when a party fails to perform part or all of the required duties under a contract.¹ Once a party fails to perform or performs inadequately, the other party—the nonbreaching party—can choose one or more of several remedies.

The most common remedies available to a nonbreaching party under contract law include damages, rescission and restitution, specific performance, and reformation. As discussed in Chapter 1, courts distinguish between *remedies at law* and *remedies in equity*. Today, the remedy at law is normally monetary damages. We discuss this remedy in the first part of this chapter. Equitable remedies include rescission and restitution, specific performance, and reformation, all of which we will examine later in the chapter. Usually, a court will not award an equitable remedy unless the remedy at law is inadequate. In the final pages of this chapter, we will look

at some special legal doctrines and concepts relating to remedies.

DAMAGES

A breach of contract entitles the nonbreaching party to sue for monetary damages. As you read in Chapter 4, damages are designed to compensate a party for harm suffered as a result of another’s wrongful act. In the context of contract law, damages are designed to compensate the nonbreaching party for the loss of the bargain. Often, courts say that innocent parties are to be placed in the position they would have occupied had the contract been fully performed.²

Types of Damages

There are basically four broad categories of damages:

- 1 Compensatory (to cover direct losses and costs).
- 2 Consequential (to cover indirect and foreseeable losses).
- 3 Punitive (to punish and deter wrongdoing).

1. *Restatement (Second) of Contracts*, Section 235(2).

2. *Restatement (Second) of Contracts*, Section 347; and Section 1–106(1) of the Uniform Commercial Code (UCC).

- 4 Nominal (to recognize wrongdoing when no monetary loss is shown).

Compensatory and punitive damages were discussed in Chapter 4 in the context of tort law. Here, we look at these types of damages, as well as consequential and nominal damages, in the context of contract law.

Compensatory Damages Damages compensating the non-breaching party for the *loss of the bargain* are known as *compensatory damages*. These damages compensate the injured party only for damages actually sustained and proved to have arisen directly from the loss of the bargain caused by the breach of contract. They simply replace what was lost because of the wrong or damage.

The standard measure of compensatory damages is the difference between the value of the breaching party's promised performance under the contract and the value of her or his actual performance. This amount is reduced by any loss that the injured party has avoided.

■ **EXAMPLE 12.1** You contract with Marinot Industries to perform certain personal services exclusively for Marinot during August for a payment of \$4,000. Marinot cancels the contract and is in breach. You are able to find another job during August but can earn only \$3,000. You normally can sue Marinot for breach and recover \$1,000 as compensatory damages. You may also recover from Marinot the amount that you spent to find the other job. ■ Expenses that are directly incurred because of a breach of contract—such as those incurred to obtain performance from another source—are called **incidental damages**.

The measurement of compensatory damages varies by type of contract. Certain types of contracts deserve special mention—contracts for the sale of goods, contracts for the sale of land, and construction contracts.

Sale of Goods. In a contract for the sale of goods, the usual measure of compensatory damages is the difference between the contract price and the market price.³ ■ **EXAMPLE 12.2** MediQuick Laboratories contracts with Cal Computer Industries to purchase ten model UTS network servers for \$8,000 each. If Cal Computer fails to deliver the ten servers, and the current market price of the servers is \$8,950, MediQuick's measure of damages is \$9,500 ($10 \times \950), plus any incidental damages (expenses) caused by the breach. ■ If the buyer breaches and the seller has not yet produced the goods, compensatory damages normally equal the seller's lost profits on the sale, rather than the difference between the contract price and the market price.

3. This is the difference between the contract price and the market price at the time and place at which the goods were to be delivered or tendered. [See UCC 2-708, 2-713, and 2-715(1), discussed in Chapter 15.]

Sale of Land. Ordinarily, because each parcel of land is unique, the remedy for a seller's breach of a contract for a sale of real estate is specific performance—that is, the buyer is awarded the parcel of property for which he or she bargained (*specific performance* will be discussed more fully later in this chapter). When this remedy is unavailable (because the property has been sold, for example) or when the buyer is the party in breach, the measure of damages is typically the difference between the contract price and the market price of the land. The majority of states follow this rule.

Construction Contracts. The measure of damages in a building or construction contract varies depending on which party breaches and when the breach occurs. The owner can breach at three different stages of the construction:

- 1 Before performance has begun.
- 2 During performance.
- 3 After performance has been completed.

If the owner breaches *before performance has begun*, the contractor can recover only the profits that would have been made on the contract (that is, the total contract price less the cost of materials and labor). If the owner breaches *during performance*, the contractor can recover the profits plus the costs incurred in partially constructing the building. If the owner breaches *after the construction has been completed*, the contractor can recover the entire contract price plus interest.

When the contractor breaches the construction contract—either by failing to begin construction or by stopping work partway through the project—the measure of damages is the cost of completion, which includes reasonable compensation for any delay in performance. If the contractor finishes late, the measure of damages is the loss of use.

Consequential Damages Foreseeable damages that result from a party's breach of contract are referred to as **consequential damages**, or *special damages*. Consequential damages differ from compensatory damages in that they are caused by special circumstances beyond the contract itself. They flow from the consequences, or results, of a breach. When a seller fails to deliver goods, knowing that the buyer is planning to use or resell those goods immediately, consequential damages are awarded for the loss of profits from the planned resale.

■ **EXAMPLE 12.3** Gilmore contracts to have a specific item shipped to her—one that she desperately needs to repair her printing press. In her contract with the shipper, Gilmore states that she must receive the item by Monday, or she will not be able to print her paper and will lose \$3,000. If the shipper is late, Gilmore normally can recover the

consequential damages caused by the delay—that is, the \$3,000 in losses. ■ To recover consequential damages, the breaching party must know (or have reason to know) that special circumstances will cause the nonbreaching party to suffer an additional loss.⁴



Sometimes, it is impossible to prevent contract disputes. You should understand that collecting damages through a court judgment requires litigation, which can be expensive and time consuming. Furthermore, court judgments are often difficult to enforce, particularly if the breaching party does not have sufficient assets to pay the damages awarded.⁵ For these reasons, parties generally choose to settle their contract disputes before trial rather than litigate in hopes of being awarded—and being able to collect—damages (or other remedies). In sum, there is wisdom in the old saying, “a bird in the hand is worth two in the bush.”

■

Punitive Damages Recall from Chapter 4 that punitive damages are designed to punish a wrongdoer and to set an example to deter similar conduct in the future. Punitive damages, or *exemplary damages*, generally are not awarded in an action for breach of contract. Such damages have no legitimate place in contract law because they are, in essence, penalties, and a breach of contract is not unlawful in a criminal sense. A contract is simply a civil relationship between the parties. The law may compensate one party for the loss of the bargain—no more and no less.

In a few situations, a person's actions can cause both a breach of contract and a tort. ■ **EXAMPLE 12.4** Two parties establish by contract a certain reasonable standard or duty of care. Failure to live up to that standard is a breach of the contract. The same act that breached the contract may also constitute negligence, or it may be an intentional tort if, for example, the breaching party committed fraud. In such a situation, it is possible for the nonbreaching party to recover punitive damages for the tort in addition to compensatory and consequential damages for the breach of contract. ■

4. UCC 2-715(2). See Chapter 16.

5. Courts dispose of cases, after trials, by entering judgments. A judgment may order the losing party to pay monetary damages to the winning party. Collecting a judgment, however, can pose problems. For example, the judgment debtor may be insolvent (unable to pay his or her bills when they come due) or have only a small net worth, or exemption laws may prevent a creditor from seizing the debtor's assets to satisfy a debt (see Chapter 21).

Nominal Damages When no actual damage or financial loss results from a breach of contract and only a technical injury is involved, the court may award **nominal damages** to the innocent party. Nominal damages awards are often small, such as one dollar, but they do establish that the defendant acted wrongfully. Most lawsuits for nominal damages are brought as a matter of principle under the theory that a breach has occurred and some damages must be imposed regardless of actual loss.

■ **EXAMPLE 12.5** Hernandez contracts to buy potatoes at fifty cents a pound from Lentz. Lentz breaches the contract and does not deliver the potatoes. Meanwhile, the price of potatoes falls. Hernandez is able to buy them in the open market at half the price he agreed to pay Lentz. Hernandez is clearly better off because of Lentz's breach. Thus, in a suit for breach of contract, Hernandez may be awarded only nominal damages for the technical injury he sustained, as no monetary loss was involved. ■

Mitigation of Damages

In most situations, when a breach of contract occurs, the injured party is held to a duty to mitigate, or reduce, the damages that he or she suffers. Under this doctrine of **mitigation of damages**, the required action depends on the nature of the situation.

■ **EXAMPLE 12.6** Some states require a landlord to use reasonable means to find a new tenant if a tenant abandons the premises and fails to pay rent. If an acceptable tenant is found, the landlord is required to lease the premises to this tenant to mitigate the damages recoverable from the former tenant. The former tenant is still liable for the difference between the amount of the rent under the original lease and the rent received from the new tenant. If the landlord has not taken the reasonable steps necessary to find a new tenant, a court will likely reduce any award by the amount of rent the landlord could have received had such reasonable means been used. ■

In the majority of states, a person whose employment has been wrongfully terminated has a duty to mitigate damages incurred because of the employer's breach of the employment contract. In other words, a wrongfully terminated employee has a duty to take a similar job if one is available. If the employee fails to do this, the damages awarded will be equivalent to the employee's salary less the income he or she would have received in a similar job obtained by reasonable means. The employer has the burden of proving that such jobs existed and that the employee could have been hired. Normally, the employee is under no duty to take a job that is not of the same type and rank.

Whether a tenant farmer acceptably attempted to mitigate his damages on his landlord's breach of their lease was at issue in the following case.

CASE 12.1 **Hanson v. Boeder**

Supreme Court of North Dakota, 2007 ND 20, 727 N.W.2d 280 (2007).
www.ndcourts.com/court/opinions.htm^a

FACTS In 1998, Paul Hanson signed a five-year lease to farm 1,350 acres of Donald Boeder's land in Steele County, North Dakota, for \$50 per acre beginning with the 1999 crop year. Under the lease, Hanson could use grain bins with a capacity of 93,000 bushels and two machine sheds on the property. The rent was \$67,515 per year, with half due on April 1 and the balance due on November 1. In 2003, Boeder and Hanson renewed the lease for a second five-year period. During both terms, Boeder and Hanson disagreed about Hanson's farming practices, but during the second term, their disagreement escalated. In August 2005, Boeder told Hanson that their lease was over. Boeder also told Hanson not to till the land in the fall because it had been leased to a new tenant who wanted to do it himself. Hanson continued to work Boeder's land, however, while running ads in the local newspapers for other farmland to rent. Unable to find other land, Hanson filed a suit in a North Dakota state court against Boeder for breach of contract, asking the court to assess damages. The court awarded Hanson \$315,194.26 to cover his lost profits, the lost use of the bins and sheds, and the value of the fall tillage. Boeder appealed to the North Dakota Supreme Court, arguing, among other things, that Hanson failed to mitigate his damages.

ISSUE Did Hanson take appropriate steps to mitigate his damages?

a. Click on the "By ND citation" link. In the result, click on "2007" and then the name of the case to access the opinion. The North Dakota Supreme Court maintains this Web site.

DECISION Yes. The Supreme Court of North Dakota affirmed the lower court's award of damages to Hanson.

REASON The state supreme court explained that normally, "for the breach of an obligation arising from contract, the measure of damages . . . is the amount which will compensate the party aggrieved for all the detriment proximately caused thereby or which in the ordinary course of things would be likely to result therefrom." The court recognized that "a person injured by the wrongful acts of another has a duty to mitigate or minimize the damages and must protect himself if he can do so with reasonable exertion or at trifling expense, and can recover from the delinquent party only such damages as he could not, with reasonable effort, have avoided." In this case, Hanson had not been aware of any farmland available for lease, and he had run ads in the local newspapers seeking other farmland to rent. That Hanson was unsuccessful affected the amount of his recovery, but it did not point to a failure to mitigate his damages.



FOR CRITICAL ANALYSIS—Social Consideration

During the trial, Boeder tried to retract his repudiation of the lease to allow Hanson to continue farming for the rest of the lease term. Should the court have considered this an acceptable way for Hanson to mitigate his damages?

Liquidated Damages versus Penalties

A **liquidated damages** provision in a contract specifies that a certain dollar amount is to be paid in the event of a future default or breach of contract. (*Liquidated* means determined, settled, or fixed.) For example, a provision requiring a construction contractor to pay \$300 for every day he or she is late in completing the project is a liquidated damages provision. Liquidated damages differ from penalties. A **penalty** specifies a certain amount to be paid in the event of a default or breach of contract and is designed to penalize the breaching party. Liquidated damages provisions normally are enforceable. In contrast, if a court finds that a provision calls for a

penalty, the agreement as to the amount will not be enforced, and recovery will be limited to actual damages.⁶

To determine whether a particular provision is for liquidated damages or for a penalty, the court must answer two questions:

- 1 At the time the contract was formed, was it apparent that damages would be difficult to estimate in the event of a breach?
- 2 Was the amount set as damages a reasonable estimate of those potential damages and not excessive?⁷

6. This is also the rule under the UCC. See UCC 2-718(1).

7. *Restatement (Second) of Contracts*, Section 356(1).

If the answers to both questions are yes, the provision normally will be enforced. If either answer is no, the provision normally will not be enforced. Liquidated damages provisions are frequently used in construction contracts because it is difficult to estimate the amount of damages that would be caused by a delay in completing the work.

EQUITABLE REMEDIES

In some situations, damages are an inadequate remedy for a breach of contract. In these cases, the nonbreaching party may ask the court for an equitable remedy. Equitable remedies include rescission and restitution, specific performance, and reformation.

Rescission and Restitution

As discussed in Chapter 11, *rescission* is essentially an action to undo, or cancel, a contract—to return nonbreaching parties to the positions that they occupied prior to the transaction. When fraud, mistake, duress, or failure of consideration is present, rescission is available. The failure of one party to perform under a contract entitles the other party to rescind the contract.⁸ The rescinding party must give prompt notice to the breaching party.

Restitution To rescind a contract, both parties generally must make **restitution** to each other by returning goods, property, or funds previously conveyed.⁹ If the physical property or goods can be returned, they must be. If the property or goods have been consumed, restitution must be made in an equivalent dollar amount.

Essentially, restitution involves the recapture of a benefit conferred on the defendant that has unjustly enriched her or him. **EXAMPLE 12.7** Andrea pays \$32,000 to Myles in return for his promise to design a house for her. The next day, Myles calls Andrea and tells her that he has taken a position with a large architectural firm in another state and cannot design the house. Andrea decides to hire another architect that afternoon. Andrea can require restitution of \$32,000 because Myles has received an unjust benefit of \$32,000. ■

Restitution Is Not Limited to Rescission Cases Restitution may be required when a contract is rescinded, but the right to restitution is not limited to rescission cases.

Restitution may be sought in actions for breach of contract, tort actions, and other actions at law or in equity. Usually, restitution can be obtained when funds or property has been transferred by mistake or because of fraud. An award in a case may include restitution of funds or property obtained through embezzlement, conversion, theft, copyright infringement, or misconduct by a party in a confidential or other special relationship.

Specific Performance

The equitable remedy of **specific performance** calls for the performance of the act promised in the contract. This remedy is often attractive to a nonbreaching party because it provides the exact bargain promised in the contract. It also avoids some of the problems inherent in a suit for monetary damages. First, the nonbreaching party need not worry about collecting the judgment. Second, the nonbreaching party need not look around for another contract. Third, the actual performance may be more valuable than the monetary damages.

Normally, however, specific performance will not be granted unless the party's legal remedy (monetary damages) is inadequate.¹⁰ For this reason, contracts for the sale of goods rarely qualify for specific performance. Monetary damages ordinarily are adequate in such situations because substantially identical goods can be bought or sold in the market. Only if the goods are unique will a court grant specific performance. For instance, paintings, sculptures, and rare books and coins are often unique, and monetary damages will not enable a buyer to obtain substantially identical substitutes in the market.

Sale of Land A court will grant specific performance to a buyer in an action for a breach of contract involving the sale of land. In this situation, the legal remedy of monetary damages will not compensate the buyer adequately because every parcel of land is unique; obviously, the buyer cannot obtain the same land in the same location elsewhere. Only when specific performance is unavailable (for example, when the seller has sold the property to someone else) will damages be awarded instead.

Is specific performance warranted when one of the parties has substantially—but not *fully*—performed under the contract? That was the question in the following case.

8. The rescission discussed here refers to *unilateral* rescission, in which only one party wants to undo the contract. In *mutual* rescission, both parties agree to undo the contract. Mutual rescission discharges the contract; unilateral rescission is generally available as a remedy for breach of contract.

9. *Restatement (Second) of Contracts*, Section 370.

10. *Restatement (Second) of Contracts*, Section 359.

CASE 12.2 **Stainbrook v. Low**

Court of Appeals of Indiana, 842 N.E.2d 386 (2006).

FACTS In April 2004, Howard Stainbrook agreed to sell to Trent Low forty acres of land in Jennings County, Indiana, for \$45,000. Thirty-two of the acres were wooded and eight were tillable. Under the agreement, Low was to pay for a survey of the property and other costs, including a tax payment due in November. Low gave Stainbrook a check for \$1,000 to show his intent to fulfill the contract. They agreed to close the deal on May 11, and Low made financial arrangements to meet his obligations. On May 8, a tractor rolled over on Stainbrook, and he died. Stainbrook's son David became the executor of his father's estate. David asked Low to withdraw his offer to buy the forty acres. Low refused and filed a suit in an Indiana state court against David, seeking to enforce the contract. The court ordered specific performance. David appealed to a state intermediate appellate court, arguing, among other things, that his father's contract with Low was "ambiguous and inequitable."

ISSUE Is complete performance of a contract required for the party to be entitled to the remedy of specific performance?

DECISION No. A party who has substantially performed or offered to perform his or her obligations under a contract is entitled to pursue specific performance as a remedy. The state intermediate appellate court held that specific performance was an appropriate remedy in this case and affirmed the lower court's order.

REASON The appellate court explained that a contracting party's substantial performance is sufficient to support a court's order for specific performance. Here, "Low both offered to perform and substantially performed his contractual obligations." The appellate court found that Low had offered to make the tax payment that was due, but Stainbrook's estate refused the offer. Also, Low had obtained financing before the closing date, and there was nothing to indicate that he was not prepared to meet his financial obligations and go forward with the sale. Moreover, although the survey had not yet been arranged, there was no evidence that Low would not have paid for the survey of the land as required by the contract. Because Low had substantially performed under the terms of the contract, the court held that Low was entitled to the remedy of specific performance.



WHY IS THIS CASE IMPORTANT? *The court reaffirmed the principle that "specific performance is a matter of course when it involves contracts to purchase real estate." The court also emphasized that "a party seeking specific performance of a real estate contract must prove that he has substantially performed his contract obligations or offered to do so." The court's reasoning underscores the importance of focusing on the elements of a principle to resolve a case fairly.*

Contracts for Personal Services Personal-service contracts require one party to work personally for another party. Courts normally refuse to grant specific performance of contracts for personal services. This is because to order a party to perform personal services against his or her will amounts to a type of involuntary servitude, which is contrary to the public policy expressed in the Thirteenth Amendment to the U.S. Constitution. Moreover, the courts do not want to monitor contracts for personal services.

EXAMPLE 12.8 If you contract with a brain surgeon to perform brain surgery on you and the surgeon refuses to perform, the court will not compel (and you certainly would not want) the surgeon to perform under these circumstances. There is no way the court can assure meaningful performance in such a situation.¹¹ ■

11. Similarly, courts often refuse to order specific performance of construction contracts because courts are not set up to operate as construction supervisors or engineers.

Reformation

Reformation is an equitable remedy used when the parties have *imperfectly* expressed their agreement in writing. Reformation allows a court to rewrite the contract to reflect the parties' true intentions. Courts order reformation most often when fraud or mutual mistake is present.

EXAMPLE 12.9 If Keshan contracts to buy a forklift from Shelley but the written contract refers to a crane, a mutual mistake has occurred. Accordingly, a court could reform the contract so that the writing conforms to the parties' original intention as to which piece of equipment is being sold. ■

Courts frequently reform contracts in two other situations. The first occurs when two parties who have made a binding oral contract agree to put the oral contract in writing but, in doing so, make an error in stating the terms. Universally, the courts allow into evidence the correct terms of the oral contract, thereby reforming the written contract. The second situation occurs when the parties have executed a written

covenant not to compete (see Chapter 9). If the covenant not to compete is for a valid and legitimate purpose (such as the sale of a business) but the area or time restraints are unreasonable, some courts will reform the restraints by making them reasonable and will enforce the entire contract as reformed. Other courts, however, will throw the entire restrictive covenant out as illegal. Exhibit 12–1 graphically presents the remedies, including reformation, that are available to the nonbreaching party.

RECOVERY BASED ON QUASI CONTRACT

Recall from Chapter 7 that a quasi contract is not a true contract but rather a fictional contract that is imposed on the parties to prevent unjust enrichment. Hence, a quasi contract provides a basis for relief when no enforceable contract exists. The legal obligation arises because the law considers that the party accepting the benefits has made an implied promise to pay for them. Generally, when one party confers a benefit on another party, justice requires that the party receiving the benefit pay a reasonable value for it.

When Quasi Contracts Are Used

Quasi contract is a legal theory under which an obligation is imposed in the absence of an agreement. It allows the courts to act as if a contract exists when there is no actual contract or agreement between the parties. The courts can also use this theory when the parties have a contract, but it is unenforceable for some reason.

Quasi-contractual recovery is often granted when one party has partially performed under a contract that is unenforceable. It provides an alternative to suing for damages and allows the party to recover the reasonable value of the partial performance. **EXAMPLE 12.10** Ericson contracts to build two oil derricks for Petro Industries. The derricks are to be built

over a period of three years, but the parties do not create a written contract. Therefore, the Statute of Frauds will bar the enforcement of the contract.¹² After Ericson completes one derrick, Petro Industries informs him that it will not pay for the derrick. Ericson can sue Petro Industries under the theory of quasi contract. ■

The Requirements of Quasi Contract

To recover on a quasi contract theory, the party seeking recovery must show the following:

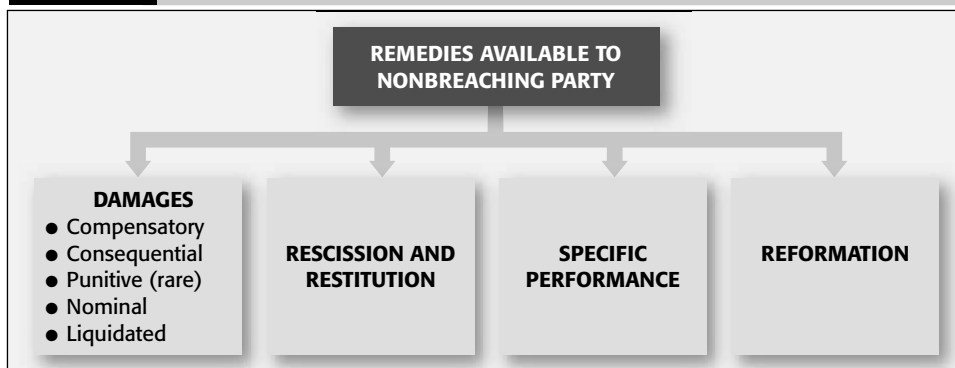
- 1 The party conferred a benefit on the other party.
- 2 The party conferred the benefit with the reasonable expectation of being paid.
- 3 The party did not act as a volunteer in conferring the benefit.
- 4 The party receiving the benefit would be unjustly enriched by retaining the benefit without paying for it.

EXAMPLE 12.11 In Example 12.10, Ericson can sue in quasi contract because all of the conditions for quasi-contractual recovery have been fulfilled. Ericson built the oil derrick with the expectation of being paid. The derrick conferred an obvious benefit on Petro Industries, and Petro Industries would be unjustly enriched if it was allowed to keep the derrick without paying Ericson for the work. Therefore, Ericson should be able to recover the reasonable value of the oil derrick that was built (under the theory of *quantum meruit*¹³—“as much as he or she deserves”). The reasonable value is ordinarily equal to the fair market value. ■

12. Contracts that by their terms cannot be performed within one year from the day after the date of contract formation must be in writing to be enforceable (see Chapter 10).

13. Pronounced *kwahn-tuhm mehr-oo-wuht*.

EXHIBIT 12–1 Remedies for Breach of Contract



CONTRACT PROVISIONS LIMITING REMEDIES

A contract may include provisions stating that no damages can be recovered for certain types of breaches or that damages will be limited to a maximum amount. The contract may also provide that the only remedy for breach is replacement, repair, or refund of the purchase price. Provisions stating that no damages can be recovered are called *exculpatory clauses* (see Chapter 9). Provisions that affect the availability of certain remedies are called *limitation-of-liability clauses*.

Whether these contract provisions and clauses will be enforced depends on the type of breach that is excused by the provision. For example, a clause excluding liability for negligence may be enforced in some cases. When an exculpatory

clause for negligence is contained in a contract made between parties who have roughly equal bargaining power, the clause usually will be enforced. The Uniform Commercial Code (UCC) specifically allows limitation-of-liability clauses to be included in contracts for the sale of goods, as will be discussed in detail in Chapter 16.¹⁴ A provision excluding liability for fraudulent or intentional injury, however, will not be enforced. Likewise, a clause excluding liability for illegal acts or violations of the law will not be enforced.

At issue in the following case was the enforceability of a limitation-of-liability clause in a home-inspection contract.

CASE 12.3 Lucier v. Williams



Superior Court of New Jersey, Appellate Division, 366 N.J.Super. 485, 841 A.2d 907 (2004).
lawlibrary.rutgers.edu/search.shtml^a

FACTS Eric Lucier and Karen Haley, first-time home buyers,

contracted to buy a single-family home for \$128,500 from James and Angela Williams in Berlin Township, New Jersey. The buyers asked Cambridge Associates, Limited (CAL), to perform a home inspection. CAL presented the buyers with a contract that limited CAL's liability to "\$500, or 50% of fees actually paid to CAL by Client, whichever sum is smaller. Such causes include, but are not limited to, CAL's negligence, errors, omissions, * * * [or] breach of contract." Lucier reluctantly signed the contract. On CAL's behalf, Al Vasys performed the inspection and issued a report. The buyers paid CAL \$385. Shortly after Lucier and Haley moved into the house, they noticed leaks, which required roof repairs estimated to cost \$8,000 to \$10,000. They filed a suit in a New Jersey state court against CAL and others, seeking damages for the loss. CAL filed a motion for summary judgment, claiming that under the limitation-of-liability clause, its liability, if any, was limited to one-half of the contract price, or \$192.50. The court granted the motion. The plaintiffs appealed to a state intermediate appellate court.

ISSUE Did the limitation-of-liability clause in the CAL contract limit the plaintiffs' recovery?

DECISION No. The state intermediate appellate court held that the provision was unenforceable. The court reversed the

a. Click on the link to "Search by party name." Select "Appellate Division," and type "Lucier" in the first box and "Williams" in the second box. Click on "Submit Form" to access the opinion. Rutgers University School of Law in Camden, New Jersey, maintains this Web site.

ruling of the lower court and remanded the case for further proceedings.

REASON The appellate court held that the limitation-of-liability clause was unenforceable for three reasons: (1) the contract was an *adhesion contract* prepared by the home inspector (an *adhesion contract* is a standard-form contract presented on a take-it-or-leave-it basis—see Chapter 9); (2) the parties had grossly unequal bargaining power; and (3) the provision undermined the fundamental purpose of the contract, having "the practical effect of avoiding almost all responsibility for the professional's negligence." Additionally, the court explained that limiting liability in home-inspection contracts is contrary to the state's public policy of requiring "reliable evaluation of a home's fitness for purchase and holding professionals to certain industry standards." The court added that "the foisting [forcing] of a contract of this type in this setting on an inexperienced consumer clearly demonstrates a lack of fair dealing by the professional. * * * If, upon the occasional dereliction, the home inspector's only consequence is the obligation to refund a few hundred dollars (the smaller of 50 percent of the inspection contract price or \$500), there is no meaningful incentive to act diligently in the performance of home inspection contracts."



FOR CRITICAL ANALYSIS—Social Consideration What is the difference between the limitation-of-liability clause in this case and an exculpatory clause (discussed in Chapter 9)?

ELECTION OF REMEDIES

In many cases, a nonbreaching party has several remedies available. Because the remedies may be inconsistent with one another, the common law of contracts requires the party to choose which remedy to pursue. This is called *election of remedies*. The purpose of the doctrine of election of remedies is to prevent double recovery. [EXAMPLE 12.12] Jefferson agrees to sell his land to Adams. Then Jefferson changes his mind and repudiates the contract. Adams can sue for compensatory damages or for specific performance. If Adams receives damages as a result of the breach, she should not also be granted specific performance of the sales contract because that would

mean she would unfairly end up with both the land and the damages. The doctrine of election of remedies requires Adams to choose the remedy she wants, and it eliminates any possibility of double recovery. ■

In contrast, remedies under the UCC are cumulative. They include all of the remedies available under the UCC for breach of a sales or lease contract.¹⁵ We will examine the UCC provisions on limited remedies in Chapter 16, in the context of the remedies available on the breach of a contract for the sale or lease of goods.

15. See UCC 2-703 and 2-711.

REVIEWING Breach and Remedies



Kyle Bruno enters into a contract with X Entertainment to be a stuntman in a movie that X Entertainment is

producing. Bruno is widely known as the best motorcycle stuntman in the business, and the movie, *Xtreme Riders*, has numerous scenes involving high-speed freestyle street-bike stunts. Filming is set to begin August 1 and end by December 1 so that the film can be released the following summer. Both parties to the contract have stipulated that the filming must end on time in order to capture the profits from the summer movie market. The contract states that Bruno will be paid 10 percent of the net proceeds from the movie for his stunts. The contract also includes a liquidated damages provision, which specifies that if Bruno breaches the contract, he will owe X Entertainment \$1 million. In addition, the contract includes a limitation-of-liability clause stating that if Bruno is injured during filming, X Entertainment's liability is limited to nominal damages. Using the information presented in the chapter, answer the following questions.

- 1 One day, while Bruno is preparing for a difficult stunt, he gets into an argument with the director and refuses to perform any stunts. Can X Entertainment seek specific performance of the contract? Why or why not?
- 2 Suppose that while performing a high-speed wheelie on a motorcycle, Bruno is injured by an intentionally reckless act of an X Entertainment employee. Will a court be likely to enforce the limitation-of-liability clause? Why or why not?
- 3 What factors would a court consider to determine if the \$1 million liquidated damages clause is valid or is a penalty?
- 4 Suppose that there was no liquidated damages clause (or the court refused to enforce it) and X Entertainment breached the contract. The breach caused the release of the film to be delayed until after summer. Could Bruno seek consequential (special) damages for lost profits from the summer movie market in that situation? Explain.

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incidental damages 243
liquidated damages 245

mitigation of damages 244
nominal damages 244
penalty 245

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specific performance 246

CHAPTER SUMMARY Breach and Remedies

COMMON REMEDIES AVAILABLE TO NONBREACHING PARTY

Damages
(See pages 242–246.)

The legal remedy designed to compensate the nonbreaching party for the loss of the bargain. By awarding monetary damages, the court tries to place the parties in the positions that they would

CHAPTER SUMMARY Breach and Remedies—Continued

Damages—Continued	<p>have occupied had the contract been fully performed. The nonbreaching party frequently has a duty to <i>mitigate</i> (lessen or reduce) the damages incurred as a result of the contract's breach. Damages can be classified in the following broad categories:</p> <ol style="list-style-type: none"> 1. <i>Compensatory damages</i>—Damages that compensate the nonbreaching party for injuries actually sustained and proved to have arisen directly from the loss of the bargain resulting from the breach of contract. <ol style="list-style-type: none"> a. In breached contracts for the sale of goods, the usual measure of compensatory damages is the difference between the contract price and the market price. b. In breached contracts for the sale of land, the measure of damages is ordinarily the same as in contracts for the sale of goods. c. In breached construction contracts, the measure of damages depends on which party breaches and at what stage of construction the breach occurs. 2. <i>Consequential damages</i>—Damages resulting from special circumstances beyond the contract itself; the damages flow only from the consequences of a breach. For a party to recover consequential damages, the damages must be the foreseeable result of a breach of contract, and the breaching party must have known at the time the contract was formed that special circumstances existed that would cause the nonbreaching party to incur additional loss on breach of the contract. Also called <i>special damages</i>. 3. <i>Punitive damages</i>—Damages awarded to punish the breaching party. Usually not awarded in an action for breach of contract unless a tort is involved. 4. <i>Nominal damages</i>—Damages small in amount (such as one dollar) that are awarded when a breach has occurred but no actual injury has been suffered. Awarded only to establish that the defendant acted wrongfully. 5. <i>Liquidated damages</i>—Damages that may be specified in a contract as the amount to be paid to the nonbreaching party in the event the contract is breached in the future. Clauses providing for liquidated damages are enforced if the damages were difficult to estimate at the time the contract was formed and if the amount stipulated is reasonable. If the amount is construed to be a penalty, the clause will not be enforced.
Rescission and Restitution (See page 246.)	<ol style="list-style-type: none"> 1. <i>Rescission</i>—A remedy whereby a contract is canceled and the parties are restored to the original positions that they occupied prior to the transaction. Available when fraud, a mistake, duress, or failure of consideration is present. The rescinding party must give prompt notice of the rescission to the breaching party. 2. <i>Restitution</i>—When a contract is rescinded, both parties must make restitution to each other by returning the goods, property, or funds previously conveyed. Restitution prevents the unjust enrichment of the parties.
Specific Performance (See pages 246–247.)	<p>An equitable remedy calling for the performance of the act promised in the contract. This remedy is available only in special situations—such as those involving contracts for the sale of unique goods or land—and when monetary damages would be an inadequate remedy. Specific performance is not available as a remedy for breached contracts for personal services.</p>
Reformation (See pages 247–248.)	<p>An equitable remedy allowing a contract to be “reformed,” or rewritten, to reflect the parties’ true intentions. Available when an agreement is imperfectly expressed in writing.</p>
Recovery Based on Quasi Contract (See page 248.)	<p>An equitable theory imposed by the courts to obtain justice and prevent unjust enrichment in a situation in which no enforceable contract exists. The party seeking recovery must show the following:</p>

(Continued)

CHAPTER SUMMARY Breach and Remedies—Continued**Recovery Based on Quasi Contract—Continued**

1. A benefit was conferred on the other party.
2. The party conferring the benefit did so with the expectation of being paid.
3. The benefit was not volunteered.
4. Retaining the benefit without paying for it would result in the unjust enrichment of the party receiving the benefit.

CONTRACT DOCTRINES RELATING TO REMEDIES**Contract Provisions Limiting Remedies**

(See page 249.)

A contract may provide that no damages (or only a limited amount of damages) can be recovered in the event the contract is breached. Clauses excluding liability for fraudulent or intentional injury or for illegal acts cannot be enforced. Clauses excluding liability for negligence may be enforced if both parties hold roughly equal bargaining power. Under the Uniform Commercial Code (UCC), remedies may be limited in contracts for the sale of goods.

Election of Remedies

(See page 250.)

A common law doctrine under which a nonbreaching party must choose one remedy from those available. This doctrine prevents double recovery. Under the UCC, remedies are cumulative for the breach of a contract for the sale of goods.

FOR REVIEW

Answers for the even-numbered questions in this For Review section can be found on this text's accompanying Web site at www.cengage.com/blaw/fbl. Select "Chapter 12" and click on "For Review."

- 1 What is the difference between compensatory damages and consequential damages? What are nominal damages, and when do courts award nominal damages?
- 2 What is the standard measure of compensatory damages when a contract is breached? How are damages computed differently in construction contracts?
- 3 Under what circumstances is the remedy of rescission and restitution available?
- 4 When do courts grant specific performance as a remedy?
- 5 What is the rationale underlying the doctrine of election of remedies?

QUESTIONS AND CASE PROBLEMS**HYPOTHETICAL SCENARIOS AND CASE PROBLEMS**

12.1 Liquidated Damages. Carnack contracts to sell his house and lot to Willard for \$100,000. The terms of the contract call for Willard to pay 10 percent of the purchase price as a deposit toward the purchase price, or as a down payment. The terms further stipulate that should the buyer breach the contract, Carnack will retain the deposit as liquidated damages. Willard pays the deposit, but because her expected financing of the \$90,000 balance falls through, she breaches the contract. Two weeks later, Carnack sells the house and lot to Balkova for \$105,000. Willard demands her \$10,000 back, but Carnack refuses, claiming that Willard's breach and the contract terms entitle him to keep the deposit. Discuss who is correct.

12.2 Hypothetical Question with Sample Answer. In which of the following situations might a court grant specific performance as a remedy for the breach of the contract?

- 1 Tarrington contracts to sell her house and lot to Rainier. Then, on finding another buyer willing to pay a higher purchase price, she refuses to deed the property to Rainier.
- 2 Marita contracts to sing and dance in Horace's nightclub for one month, beginning June 1. She then refuses to perform.
- 3 Juan contracts to purchase a rare coin from Edmund, who is breaking up his coin collection. At the last minute, Edmund decides to keep his coin collection intact and refuses to deliver the coin to Juan.

- 4 Astro Computer Corp. has three shareholders: Coase, who owns 48 percent of the stock; De Valle, who owns 48 percent; and Cary, who owns 4 percent. Cary contracts to sell his 4 percent to De Valle but later refuses to transfer the shares to him.



For a sample answer to Question 12.2, go to Appendix E at the end of this text.

- 12.3 Measure of Damages.** Johnson contracted to lease a house to Fox for \$700 a month, beginning October 1. Fox stipulated in the contract that before he moved in, the interior of the house had to be completely repainted. On September 9, Johnson hired Keverer to do the required painting for \$1,000. He told Keverer that the painting had to be finished by October 1 but did not explain why. On September 28, Keverer quit for no reason, having completed approximately 80 percent of the work. Johnson then paid Sam \$300 to finish the painting, but Sam did not finish until October 4. When Fox found that the painting had not been completed as stipulated in his contract with Johnson, he leased another home. Johnson found another tenant who would lease the property at \$700 a month, beginning October 15. Johnson then sued Keverer for breach of contract, claiming damages of \$650. This amount included the \$300 Johnson paid Sam to finish the painting and \$350 for rent for the first half of October, which Johnson had lost as a result of Keverer's breach. Johnson had not yet paid Keverer anything for Keverer's work. Can Johnson collect the \$650 from Keverer? Explain.

- 12.4 Waiver of Breach.** In May 1998, RDP Royal Palm Hotel, L.P., contracted with Clark Construction Group, Inc., to build the Royal Palms Crowne Plaza Resort in Miami Beach, Florida. The deadline for "substantial completion" was February 28, 2000, but RDP could ask for changes, and the date would be adjusted accordingly. During construction, Clark faced many setbacks, including a buried seawall, contaminated soil, the unforeseen deterioration of the existing hotel, and RDP's issue of hundreds of change orders. Clark requested extensions of the deadline, and RDP agreed, but the parties never specified a date. After the original deadline passed, RDP continued to issue change orders, Clark continued to perform, and RDP accepted the work. In March 2002, when the resort was substantially complete, RDP stopped paying Clark. Clark stopped working. RDP hired another contractor to finish the resort, which opened in May. RDP filed a suit in a federal district court against Clark, alleging, among other things, breach of contract for the two-year delay in the resort's completion. In whose favor should the court rule, and why? Discuss. [*RDP Royal Palm Hotel, L.P. v. Clark Construction Group, Inc.*, ___ F.3d ___ (11th Cir. 2006)]

- 12.5 Case Problem with Sample Answer.** Tyna Ek met Russell Peterson in Seattle, Washington. Peterson persuaded Ek to buy a boat that he had once owned, the *O'Hana Kai*, which was in Juneau, Alaska. Ek paid the boat's current owner \$43,000 for the boat, and in January 2000, she and Peterson entered into a contract, under which Peterson agreed to


make the vessel seaworthy so that within one month it could be transported to Seattle, where he would pay its moorage costs. He would renovate the boat at his own expense in return for a portion of the profit on its resale in 2001. On the sale, Ek would recover her costs, and then Peterson would be reimbursed for his. Ek loaned Peterson her cell phone so that they could communicate while he prepared the vessel for the trip to Seattle. In March, Peterson, who was still in Alaska, borrowed \$4,000 from Ek. Two months later, Ek began to receive unanticipated, unauthorized bills for vessel parts and moorage, the use of her phone, and charges on her credit card. She went to Juneau to take possession of the boat. Peterson moved it to Petersburg, Alaska, where he registered it under a false name, and then to Taku Harbor, where the police seized it. Ek filed a suit in an Alaska state court against Peterson, alleging breach of contract and seeking damages. If the court finds in Ek's favor, what should her damages include? Discuss. [*Peterson v. Ek*, 93 P.3d 458 (Alaska 2004)]



After you have answered Problem 12.5, compare your answer with the sample answer given on the Web site that accompanies this text. Go to www.cengage.com/blaw/fbl, select "Chapter 12," and click on "Case Problem with Sample Answer."

- 12.6 Remedies.** On July 7, 2000, Frances Morelli agreed to sell to Judith Bucklin a house at 126 Lakedell Drive in Warwick, Rhode Island, for \$77,000. Bucklin made a deposit on the house. The closing at which the parties would exchange the deed for the price was scheduled for September 1. The agreement did not state that "time is of the essence," but it did provide, in "Paragraph 10" that "[i]f Seller is unable to [convey good, clear, insurable, and marketable title], Buyer shall have the option to: (a) accept such title as Seller is able to convey without abatement or reduction of the Purchase Price, or (b) cancel this Agreement and receive a return of all Deposits." An examination of the public records revealed that the house did not have marketable title. Wishing to be flexible, Bucklin offered Morelli time to resolve the problem, and the closing did not occur as scheduled. Morelli decided "the deal is over" and offered to return the deposit. Bucklin refused and, in mid-October, decided to exercise her option under Paragraph 10(a). She notified Morelli, who did not respond. Bucklin filed a suit in a Rhode Island state court against Morelli. In whose favor should the court rule? Should damages be awarded? If not, what is the appropriate remedy? Why? [*Bucklin v. Morelli*, 912 A.2d 931 (R.I. 2007)]
- 12.7 Contract Limits on Damages.** David Hanson was flying on American West Airlines. In his carry-on duffel bag, he carried a robotic head that was worth about \$750,000. (This head was used in making movies.) When he transferred to another plane, he forgot about his duffel bag, which he had stored above his seat. When he got to his final destination, he reported the loss and was told that the airline had retrieved the bag and its contents and that the airlines would send it to him. But it never arrived. Hanson sued for

damages for breach of contract. The airline requested a summary judgment. The ticket Hanson had purchased stated that there was a \$2,800 damage limit for checked baggage, per passenger, and that there was no liability for items passengers carry on board a plane. Is this sort of damage restriction by American West Airlines reasonable? Why or why not? [*Hanson v. American West Airlines*, 544 F.Supp.2d 1038 (C.D. Cal. 2008)]


- 12.8**  **A Question of Ethics.** In 2004, Tamara Cohen, a real estate broker, began showing property in Manhattan to Steven Galistinos, who represented comedian Jerry Seinfeld and his wife, Jessica. According to Cohen, she told Galistinos that her commission would be 5 or 6 percent, and he agreed. According to Galistinos, there was no such agreement. Cohen spoke with Maximillan Sanchez, another broker, about a townhouse owned by Ray and Harriet Mayeri. According to Cohen, Sanchez said that the commission would be 6 percent, which they agreed to split equally. Sanchez later acknowledged that they agreed to split the fee, but claimed that they did not discuss a specific amount. On a Friday in February 2005, Cohen showed the townhouse to Jessica. According to Cohen, she told Jessica that the commission would be 6 percent, with the Seinfelds paying half, and Jessica agreed. According to Jessica, there was no such conversation. Later that day, Galistinos asked Cohen to arrange for the Seinfelds

to see the premises again. Cohen told Galistinos that her religious beliefs prevented her from showing property on Friday evenings or Saturdays before sundown. She suggested the following Monday or Tuesday, but Galistinos said that Jerry would not be available and asked her to contact Carolyn Liebling, Jerry's business manager. Cohen left Liebling a message. Over the weekend, the Seinfelds toured the building on their own and agreed to buy the property for \$3.95 million. Despite repeated attempts, they were unable to contact Cohen. [*Cohen v. Seinfeld*, 15 Misc.3d 1118(A), 839 N.Y.S.2d 432 (Sup. 2007)]

- The contract between the Seinfelds and the Mayeris stated that the sellers would pay Sanchez's fee and the "buyers will pay buyer's real estate broker's fees." The Mayeris paid Sanchez \$118,500, which is 3 percent of \$3.95 million. The Seinfelds refused to pay Cohen. She filed a suit in a New York state court against them, asserting, among other things, breach of contract. Should the court order the Seinfelds to pay Cohen? If so, is she entitled to a full commission even though she was not available to show the townhouse when the Seinfelds wanted to see it? Explain.
- What obligation do parties involved in business deals owe to each other with respect to their religious beliefs? How might the situation in this case have been avoided?



CRITICAL THINKING AND WRITING ASSIGNMENTS

- 12.9 Critical Legal Thinking.** Review the discussion of the doctrine of election of remedies in this chapter. What are some of the advantages and disadvantages of this doctrine?
- 12.10**  **Video Question.** Go to this text's Web site at www.cengage.com/blaw/fbl and select "Chapter 12." Click on "Video Questions" and view the video titled *Midnight Run*. Then answer the following questions.
- In the video, Eddie (Joe Pantoliano) and Jack (Robert De Niro) negotiate a contract for Jack to find "the Duke," a mob accountant who embezzled funds, and bring him back

for trial. Assume that the contract is valid. If Jack breaches the contract by failing to bring in the Duke, what kinds of remedies, if any, can Eddie seek? Explain your answer.

- Would the equitable remedy of specific performance be available to either Jack or Eddie in the event of a breach? Why or why not?
- Now assume that the contract between Eddie and Jack is unenforceable. Nevertheless, Jack performs his side of the bargain by bringing in the Duke. Does Jack have any legal recourse in this situation? Explain.

ACCESSING THE INTERNET



For updated links to resources available on the Web, as well as a variety of other materials, visit this text's Web site at

www.cengage.com/blaw/fbl

The following site offers a brief summary of and several related articles on breach of contract:

www.legalmatch.com/law-library/article/breach-of-contract.html

PRACTICAL INTERNET EXERCISES

Go to this text's Web site at www.cengage.com/blaw/fbl, select "Chapter 12," and click on "Practical Internet Exercises." There you will find the following Internet research exercises that you can perform to learn more about the topics covered in this chapter.

PRACTICAL INTERNET EXERCISE 12-1 LEGAL PERSPECTIVE—Contract Damages and Contract Theory

PRACTICAL INTERNET EXERCISE 12-2 MANAGEMENT PERSPECTIVE—The Duty to Mitigate

BEFORE THE TEST

Go to this text's Web site at www.cengage.com/blaw/fbl, select "Chapter 12," and click on "Interactive Quizzes." You will find a number of interactive questions relating to this chapter.

12.2A HYPOTHETICAL QUESTION WITH SAMPLE ANSWER

Generally, the equitable remedy of specific performance will be granted only if two criteria are met: monetary damages (under the circumstances) must be inadequate as a remedy, and the subject matter of the contract must be unique.

1. In the sale of land, the buyer's contract is for a specific piece of real property. The land under contract is unique, because no two pieces of real property have the same legal description. In addition, monetary damages would not compensate a buyer adequately, as the same land cannot be purchased elsewhere. Specific performance is an appropriate remedy.

2. The basic criteria for specific performance do not apply well to personal service contracts. If the identical service contracted for is readily available from others, the service is not unique and monetary damages for nonperformance are adequate. If, however, the services are so personal that only the contracted party can perform them, the contract meets the test of uniqueness; but the courts will refuse to decree specific performance based on either of two theories. First, the enforcement of specific performance requires involuntary servitude (prohibited by the Thirteenth Amendment to the U. S. Constitution). Second, it is impractical to attempt to force meaningful performance by someone against his or her will. In the case of Marita and Horace, specific performance is not an appropriate remedy.

3. A rare coin is unique, and monetary damages for breach are inadequate, as Juan cannot obtain a substantially identical substitute in the market. This is a typical case where specific performance is an appropriate remedy.

4. The key fact for consideration here is that this is a closely held corporation. Therefore, the stock is not available in the market, and the shares become unique. The uniqueness of these shares is enhanced by the fact that if Cary sells his 4 percent of the shares to De Valle, De Valle will have a controlling voice in the corporation. Because of this, monetary damages for De Valle are totally inadequate as a remedy. Specific performance is an appropriate remedy.

This page contains answers for this chapter only.