Problem 12-1

Material and Total Breach

The problem provides facts that indicate that a contract was formed between Michaels and Big Burger. Mutual assent would not be a problem and the parties appear to have executed a written contract that would satisfy the Statute of Frauds (applicable since the contract could not be fully performed within one year from the date of making).

The problem also indicates that we should assume that there was a material breach on the part of Big Burger resulting from Big Burger's delivery of bad quality products to Michaels and its failure to conduct a major advertising campaign after the opening of Michaels' restaurant. It would be a good exercise, however, to consider how the terms in the contract regarding these duties might have been drafted and interpreted. Once the obligations of Big Burger are properly understood, one would need to assess the degree to which Big Burger's performance failed to conform to the contract duties.

In order for Michaels to consider the contract discharged due to Big Burger's nonperformance, Michaels would first need to establish that Big Burger committed a material breach as defined by the Restatement (2d) §241, ultimately whether the nonbreaching party is receiving the essentially what was bargained for. If Big Burger's breach is material, then we next have to ask if the breach is also total and the contract discharged. Under much of the case law, Michaels would have the option of treating the material breach as total, but the Restatement 2d §242 would require that there be other factors present to cause the material breach to also be total, such as there being risk of further injury to the nonbreaching party from more delay and little likelihood of cure by the breaching party.

(Parenthetically, if by some chance the breach by Big Burger is immaterial, then Michaels would have committed the first material breach by declaring the contract over and she would be liable for damages to Big Burger.)

Misrepresentation/ Fraud

An important question is whether Big Burger made binding commitments concerning the projected profits that Michaels would make through the franchise. Big Burger is likely to assert that the projections were merely predictions or puffery and not the kind of firm commitment for which it could be liable. (See note 3 on page 552.)

If Michaels can establish the Big Burger projections amounted to definite commitments, then it might open the door to a claim of misrepresentation. Under the elements of Restatement 2d §164, Michaels would need to show that the Big Burger made the projections knowing that there were false (or perhaps with reckless disregard for whether they were true), that she reasonably relied on those projections, and that she was injured. If all the elements of misrepresentation are present, then the contract would be voidable by Michaels and rescission with restitution should be available. Michaels might prefer to sue for breach of contract, however, given the remedial possibilities discussed below.

Expectation Damages

Michaels would first argue that she should be entitled to recover expectation damages due to the material breach by Big Burger. This computation can be subdivided into two parts: the lost income to date and the future lost income. Michaels began operations in January 2001. The facts state that she brought suit in "late 2002." For ease of computation I will assume the business had been in operation for two years. The company projected that Michaels would receive an average annual net profit of $75,000 plus an owner's salary of $50,000. Instead, Michaels only received $20,000 in salary per year. Thus, Michaels has suffered a "loss in value" of $105,000 for each of the first two years. Big Burger might argue that Michaels cannot prove these damages with reasonable certainty. However, this argument may be especially difficult for it to sustain because the figures being used were ones supplied by the company itself. Michaels does not appear to have any "other loss," consequential damages incurred because of the breach of contract by Big Burger. There would be no "cost avoided" to subtract from this sum because these are net profit figures; all costs have already been taken into account.

The court would take into account the fact that Michaels would be collecting on a projected stream of future earnings. An expert would take into account factors such as the going interest rate, inflation rates, the earnings history of the business, and the earnings for comparable businesses in computing the present award of damages for future income.

Note that Michaels could not recover her expenses incurred in obtaining and operating the franchise. This would be a double recovery because these expenses had to be incurred for her to obtain the profit calculated above.

Certainty: In addition Michaels expected to receive a stream of income of $125,000 per year into the future (consisting of net profit plus owner's salary). While Big Burger might argue that these damages are too speculative to be recovered, Michaels's response will be the same as above: These are the figures that Big Burger itself supplied.

Mitigation: Michaels would be able to avoid some of the loss by taking other employment. Big Burger would have the burden of proving that Michaels could obtain comparable employment. Recall the notes after the *Boehm v. American Broadcasting Co.* case in Chapter 11. Big Burger might plausibly argue that Michaels could obtain a job similar to the one she had before she became a franchisee, at a salary of $25,000 per year. If this claim is accepted, Michaels will have a projected annual loss of $100,000 per year.

Big Burger might also claim that Michaels's recovery should be reduced by the reasonable resale or salvage value of the equipment, arguing that she has a duty to mitigate her damages by disposing of this equipment. Instead of using the equipment for the next eight years, Michaels would collect the value of selling it at the time of the lawsuit.

Nonrecoverable damages: [Note: These issues probably would not be discussed on an exam because the facts do not raise them.] By the way, Michaels would have little chance of recovering her attorney fees, punitive damages, damages for emotional distress, or prejudgment interest. Unless the contract provided for attorney fees, the situation does not seem to fall within any of the exceptions to the American rule. In particular, there is no evidence of bad faith conduct on Big Burger's part, only an ordinary breach. Punitive damages are not generally recoverable unless the breach of contract amounts to a tort. Restatement (Second) §355. Perhaps Michaels could argue that Big Burger engaged in fraud in connection with the financial projections. If so punitive damages might be awarded. Damages for emotional distress in contract actions are not generally awarded when the contract is purely commercial in nature, rather than having personal elements. Recall *Erlich v. Menezes,* in Chapter 11; see also Restatement (Second) §353. Here the contract appears to be purely commercial. Prejudgment interest may be recovered if the damages are liquidated, a fixed or readily ascertainable sum. Damages for lost profits do not seem to fit this requirement because the amount and valuation are matters of judgment, not fixed determination.

Reliance Damages

If a court concludes that Michaels is not entitled to recover expectation damages because those damages are too speculative, she would still be entitled to recover reliance damages. *Wartzman v. Hightower Productions, Ltd.,* page 925; Restatement (Second) §349. Reliance damages include expenses in preparation for, or in part performance of, a contract, the amount of income forgone to enter into the contract, and other expenses in reliance. Those expense would include:

Franchise fee:	$100,000
Equipment:	$ 50,000 (-$25,000)

Note: The reasonable resale value of the equipment should be deducted from Michaels's recovery because reliance damages should be reduced by the cost of mitigation. Assuming that the equipment could be resold for 50% of cost, damages would be reduced by $25,000.

Pre-contract Expenses:	$15,000

Note: Michaels might also try to recover her legal and traveling expenses incurred before the contract. This might pose a problem; Big Burger could argue that expenses incurred before making the contract cannot be in reliance on the contract. On the other hand, one could argue that the expenses were incurred in contemplation of the contract and were foreseeable by Big Burger on the part of any prospective franchisee.

Forgone opportunities:	$10,000

Note: Michaels gave up a job in which she was earning $25,000 per year. In her franchise operations she received only $20,000 per year in salary, resulting in a net loss to her of $5,000 per year. A court might also award some amount to compensate her for lost income until she obtains another job.

Total reliance damages	$150,000

Restitutionary Damages

A nonbreaching party may elect to recover restitutionary damages for breach of contract rather than either expectation or reliance damages. *United States ex rel. Coastal Steel Erectors, Inc. v. Algernon Blair, Inc.*, page 942; Restatement (Second) §373. Restitutionary damages for breach of contract are generally measured by the fair market value of the performance. The amount of restitution is reduced by the value of any benefits that the plaintiff received under the contract. Here the fair market value of Michaels's performance would include the $100,000 franchise fee and arguably the value of her personal services or two years.

Measuring the value of Michael's performance could be difficult but three possibilities are readily apparent: $20,000 per year as the amount she earned; $25,000 as what she could have earned in her prior work; and $50,000 as Big Burger's estimation of the value of the manager's position. Michael's would obviously assert that $50,000 per year is the right amount. For two years she received $20,000 in salary which would have to be taken into account. If the court agrees with the latter approach, her net recovery in restitution would be $160,000. Michaels also paid Big Burger rental for the restaurant and a percentage of sales. I assume, however, that these amounts were taken into account in determining net profits. Thus, these expenses were "washed out" by the income that she received during the two years.