<u>Problem 11-1</u> (p. 935)

<u>Direct Damages; Loss in Value</u>. A preliminary issue that must be addressed before determining the Tans' damages is whether Article 2 of the UCC applies. Article 2 applies to "transactions in goods," UCC §2-102. We are told that the contract called for the purchase of the Tans' 12 stores. Purchase of the stores would include their inventory, which clearly qualifies as goods under the Code. On the other hand, much of the value of the stores may be in their "good will," an intangible asset that would not constitute goods. See UCC §2-105(1) (exclusion from goods of "things in action"). Also, we are not told whether the contract for sale called for the purchase of the assets of the Tans' drug store business or for the purchase of the common stock in their corporation (assuming that the Tans incorporated their business). If the sale involves a purchase of securities, Article 2 does not apply. See UCC §2-105(1) (exclusion of investment securities and things in action).

If the Code does not apply to the transaction, then the general measure of damages for breach of a contract of sale applies: contract price minus market price. See *Roesch v. Bray*, page 851. This measure is equivalent to the Code's market damages measure, §2-708(1), and would also require expert testimony on market value.

<u>Consequential Damages: Interest</u>. Under general contract damage principles, in addition to direct damages or loss in value, a nonbreaching party is also entitled to recover incidental and consequential damages. Restatement (Second) of Contracts §347(b). Courts have, however, generally denied damages for prejudgment interest unless the damages constitute a liquidated amount. See note 5, pages 856-857. The purchase price of $4.5 million would seem to qualify as a liquidated amount. Thus, the Tans should be able to recover prejudgment interest on $4.25 million up to the time of their sale ($250,000 was held in escrow) and prejudgment interest on $1.75 million from the time of sale to judgment. This approach is the general rule, notwithstanding the apparent decision in *Roesch v. Bray* not to allow the nonbreaching sellers to recover prejudgment interest. See pages 852-853. After judgment is entered, the Tans would be entitled to postjudgment interest at the statutory rate. See note 5, pages 856-857.

<u>Consequential Damages: Loss of Investment Value</u>. Consequential damages are only recoverable if they meet the requirements of foreseeability, proof with reasonable certainty, and mitigation. See Restatement (Second) of Contracts §§§351 (unforeseeability), 352 (uncertainty), 350 (avoidability); *Florafax International, Inc. v. GTE Market Resources, Inc.*, page 874. The Tans should be able to prove the loss of investment value with reasonable certainty since the prices of mutual funds are published, but they will have difficulty satisfying the requirement of foreseeability. Loss in investment value is not the kind of damage that arises in the "ordinary course of events" from a breach, so the Tans would need to show that Simpson's had "reason to know" of their intended use of the sale proceeds. In addition, Simpson's must have had reason to know of the Tans' planned investment at the time the contract was formed. See Restatement (Second) of Contracts §351(1) ("when the contract was made"; and 352(2)(b) ("reason to know"); *Hadley v. Baxendale* at page 869 and Note 3 pages 872-873. Perhaps the contract of sale has some reference to the Tans' planned use of the proceeds of the sale. It is possible that

during the negotiations of the sale, either the Tans or Evans informed Simpson's of the Tans' planned investment. Careful factual investigation may reveal evidence sufficient to create a question of fact as to Simpson's knowledge about the Tans' investment at the time the contract was made.

The doctrine of avoidability or mitigation of damages does not seem to pose a barrier to the Tans' recovery of investment value. After Simpson's breach, the only mitigating options available to the Tans were to attempt to resell their stores, which they did, and to borrow to make the investment that they planned to make. It would be extraordinary for a court to hold that a seller was required to borrow money to make an investment in order to mitigate damages. Further, the burden of proof would be on Simpson's to establish that the Tans could have made such a loan. See *Havill v. Woodstock Soapstone*, page 890, and note 2 page 899-900 (burden of proving mitigation on breaching party).

If the Code governs the transaction, then the Tans will need to overcome the statutory construction issue about the seller's right to recover consequential damages discussed above in addition to meeting the common law requirement of foreseeability, certainty, and mitigation.

If the Tans are successful in recovering damages for loss in investment value, they could not also obtain prejudgment interest because an award of both lost investment value and prejudgment interest would be a double recovery. Had the Tans received the purchase price of $4.5 million on October 15, 2006, they could have invested it in a U.S. Treasury Bond Fund or earned interest through a bank certificate of deposit, but not both.

<u>Incidental Damages/Cost Avoided: Commissions Paid to Evans</u>. Under both general contract principles and under the Code, a seller is entitled to recover incidental damages. See Restatement (Second) of Contracts §347(b); UCC §2-710. Incidental damages include expenses incurred to deal with the consequences of the breach. Incidental damages, like other damages, are subject to the general expectation principle: Compensation should not place the injured party in a better position than the party would have been in had the breaching party fully performed.

If Simpson's had performed the contract, the Tans would have been responsible for Evans's commission in the amount of $225,000 (5% of $4.5 million). The Tans have actually incurred commission expenses totaling $181,250. Thus, if the Tans recover damages equivalent to the purchase price of $4.5 million, they should not be entitled to recover any commission expenses. In fact, the breach saves the Tans $43,750 in commissions, so this amount should be deduced as a cost avoided. The Tans might have a claim for a portion of their commission expenses if they recover less than the contract price. For example, suppose the court or jury awards the Tans $1.25 million in damages using a market value measure of damages and appraising the business as having a market value of $3 million. ($4.5 million contract price, less $3 million market value, less $250,000 paid in escrow). To sell the business for $3 million the Tans would have had to incur a commission of $150,000. They actually paid $181,250, so they should be able to recover $31,250 in commission expenses from Simpson's as incidental damages.

<u>Incidental Damages; Attorney Fees.</u> The American Rule provides that legal expenses incurred in litigation are generally not recoverable damages. See *Zapata Hermanos Sucesores, S.A. v. Hearthside Baking Co.*, page 911. The American Rule has a number of exceptions; the one most likely to be applicable to this case is the contract exception. See note 4, page 918. If the contract between the Tans and Simpson's provides that the nonbreaching party is entitled to recover attorney fees, the provision should be enforceable. Sometimes contracts provide for one-sided attorney fee provisions. If the contract had such a provision benefitting Simpson's but not the Tans, a court might be willing to construe the provision to be applicable to the Tans, or a statutory provision might dictate that construction. See, e.g., Cal. Civil Code §1717 (1998). If the UCC applies to this case, the Tans are still not likely to be able to recover attorney fees absent a contractual provision; most courts have held that the American Rule applies to the Code. See Note 2, page 917.

<u>Consequential Damages: Emotional Distress</u>. The general rule is that damages for emotional distress are not recoverable unless the breach caused "bodily harm" or the contract is one in which "serious emotional disturbance was a particularly likely result." Restatement (Second) §353; *Erlich v. Menezes*, page 920. Since this case involves a commercial contract, a court would probably reject the claim that emotional disturbance was a particularly likely result of this contract. See note 4 pages 930-931. Mr. Tan may, however, be able to show that the breach caused bodily harm because he suffered a heart attack as a result of the stress of the contract litigation. Simpson's will contend that the breach did not cause Mr. Tan's heart attack. His medical history would be relevant here. If he had a preexisting heart condition, the company's case on lack of causation would be strengthened, perhaps to the point that the court would strike this element of damages. The company could also argue that Mr. Tan's heart attack was brought on by the delay in selling to Rite-Buy rather than by its breach of contract. Whether Simpson's breach was the cause of Mr. Tan's heart attack would seem to be a question of fact for the jury.

<u>Punitive Damages</u>. For a time some courts accepted the proposition that a willful or particularly egregious breach of contract could constitute a tort for which punitive damages were recoverable. See the discussion of Seaman's Direct Buying Service, Inc. v. Standard Oil Co., at page 933. *Seaman's* has now been overruled by Freeman & Mills, Inc. v. Belcher Oil Co., as reflected in the discussion at pages 933-934, and other courts have also retreated from this position. Today, outside of the insurance setting, punitive damages will be available in a contract action only if the conduct constituting the breach is a tort for which punitive damages are recoverable. Restatement (Second) of Contracts §355 and page 933. It seems unlikely that the Tans can meet this standard. Simpson's never responded to the Tans' request that they complete the sale, so it is difficult to see how its conduct could amount to a tort like fraud or duress. The Tans could argue that Simpson's engaged in fraud at the time it entered into the contract because Simpson's never had an intention to perform. This position will also be difficult to sustain because it appears that Simpson's breached the contract because it changed its corporate strategy due to a radical and sudden shift in the industry. In the absence of additional facts, the Tans are unlikely to be able to obtain punitive damages.