

Western University

Law and Economics

Lecture 9



Remedies stipulated by parties

- stipulated damages
- a remedial process
 - arbitration



Court-provided remedies

- money damages: To compensate the promisee for the injury caused by the promisor.
- specific performance: the court orders the breaching party to perform.



Alternative damages

- Damages for breach of contract compensate the promisee for the *injury* caused by the promisor.



Expectation damages

- The promisee is worse off than if the contract had been performed. The promisee expects to gain from "performance." The common law tradition refers to damages based upon the value of expected performance as "expectation damages."
- Expectation damages leave potential victims indifferent between performance and breach.



Example 1

- O ticket agency offers opera tickets at the price p_o . K ticket agency offers equivalent tickets at the lower price p_k . Consumer orders x_k tickets from K at the price p_k and promises to pay when he picks up the tickets on the day of performance.
- Close to the day of the performance, K announces that it will breach and not deliver the tickets to Consumer. In the meantime, the show has succeeded and the price of tickets has risen, so Consumer pays the higher price, p_s , for substitute tickets purchased from a third ticket agency.



Example 2

- K ticket agency offers opera tickets at the price p_K . Consumer orders x_K tickets from K and promises to pay when he picks up the tickets on the day of performance.
- In reliance on Consumer's promise, K purchased x_K tickets at the wholesale price p_W .
- Close to the day of the performance, Consumer announces that he will breach. K resells the tickets at the lower price p_S to another consumer.



Reliance damages

- The promisee may invest in reliance upon the promise. Reliance increases the loss resulting from breach. Breach usually diminishes or destroys the value of the investment in reliance.
- Breach makes promisee who relied worse off than if he had not made the contract.



Opportunity cost

- Making a contract often entails the loss of an opportunity to make an alternative contract. The lost opportunity provides a baseline for computing the injury



Hawkins v. McGee

- **Facts**

McGee is a doctor and Hawkins was his patient. Hawkins paid McGee to perform surgery on his hand. Hawkins testified that McGee guaranteed the hand would turn out "100% perfect" or "100% good". It did not turn out that good (called 'the hairy hand' case).
- The issue before the court was what type of damages should be awarded.

- The trial court's instructions to the jury suggested that they award damages based on pain and suffering plus any injury over and above what the plaintiff had before the surgery.

- **Decision**

The damages that should be awarded are the difference between the value of what the plaintiff would have received if the contract had been carried out and the value the plaintiff currently possesses.



Restitution remedy

- In a deferred exchange, one party often gives something in exchange for the other party's promise to do something later. Restitution remedy requires the breaching party to return what was given from the victim.



Disgorgement

- Disgorgement damages are damages paid to victim to eliminate the injurer's profit from wrongdoing.



Specific Performance

- Specific performance usually requires the promisor to do what he or she promised in the contract.
- Ex) sale of goods in which no close substitutes exist.



Party-designed remedies:

- Stipulated [liquidated] damages are a sum of money stipulated in the contract that the promise-breaker pays to the innocent party.

Cf. Liquidated damages vs. penalties.

- * insurance premium
- * signaling credibility



Penalty vs. bonus

- Seller receives \$90 from Buyer for a promise to deliver goods that Buyer values at \$100 in one month. The parties would like to stipulate that Seller pays Buyer damages of \$125 for breach of contract.
- Alternatively, Buyer pays Seller \$65 on signing the contract and Buyer pays Seller \$25 as a bonus for performance.



Efficient Breach and Performance

Two types of contingencies

- Unfortunate contingency:
Performance is more costly than non-performance
- Fortunate contingency:
Non-performance is more profitable than performance.



Example

- Person A values living in his house at \$90,000, and person B values living in A's house at \$110,000.
- A promises to sell the house to B for \$100,000.
- C values the house at \$126,000. C offers to pay \$118,000 for the house.


