MANAGING CONTRACTUAL RISKS | DAMAGES

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INTRODUCTION

At times a party to a contract will not hold their end of the said contract. Usually when a contract is breached the injured party has a number of options to choose from to remedy their position and such include;

- Refusing further performance of the contract
- To bring an action for damages
- To sue on a *quantum meruit*
- To sue for specific performance
- To sue for injunction

In this pdf notes we are focusing on damages, specifically how to calculate damages in a contract

What are damages?

Damages generally mean money awarded to a party who has suffered loss or injury as a result of breach of a contract by the other party.

You should distinguish damages from a fine which is money that a court can award the injured party. The difference is in the intention in the sense that with damages the intention is to compensate the injured party, while with a fine the intent is to punish the accused if found liable. Fines are used in criminal cases while damages are used in civil cases.

RELATED: The legal difference between a crime and a civil wrong (click to watch video)

Whenever there is a breach of contract the aggrieved party is entitled to bring action for damages, assuming they are entitled to substantial damages, otherwise the party can only sue for nominal damages. **Nominal damages** are the kind of damages that recognizes that the party's legal rights were infringed.

HOW TO CALCULATE DAMAGES IN A CONTRACT

In the event of an action for damages as a result of breach of contract the following rules will help in the calculation of damages;

#1 loss of bargain, which means that the injured party is to be returned to the same financial position as if the contract has been performed

What this means in a simpler context is, if you contract for someone to do a given job or supply certain items, damages amount to the loss you incur if they fail to perform the job. If the job is done in a defective manner then the damage (loss of bargain) is the cost you incurred to correct the defect. Of course if this approach leads to an unreasonable amount the court can settle for the value difference between what you contracted for and what you got. This is referred to as **diminution in value**.

#2 difference in value approach which is common in sale of goods contracts

If the buyer refuses to take delivery of the goods, according to sale of goods act, the seller's damages, unless proved otherwise, is the difference between the contract price and the market price if the market price is lower, on the day the delivery should have been accepted. The reverse is true to the buyer if the seller fails to deliver the goods on the agreed day

RELATED: check out video lessons on sale of goods contracts

#3 The plaintiff is not to be compensated for more than the his true loss

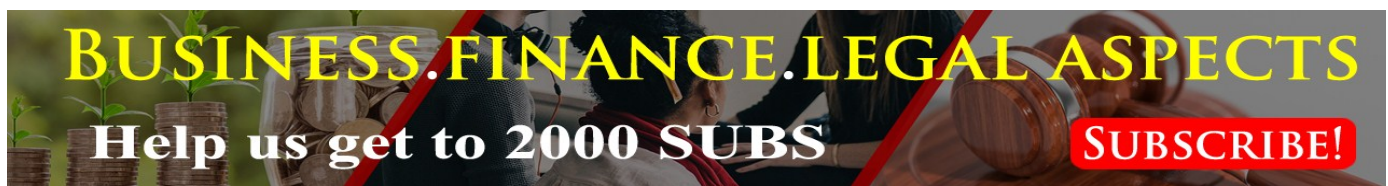
This is why when calculating how much one gets, tax liability of the person can also, at time, be taken into account.

For example;

> ***British Transportation commission v Gourley (1956)***
>
> G, a civil engineer, was injured in a railway accident for which the British transport commission accepted the liability. The damages for earnings, actual and prospective, were agreed to be £ 37, 720 but, income tax and surtax, to which G was liable, were taken into account they would be reduced to £ 6,695.
>
> **HELD:** It would be unrealistic to ignore the tax element; if the tax liability were not taken into account G would receive more than he had lost. Consequently B.T.C had to only pay the lower amount.

#4 The damages must be for losses that were reasonably foreseeable, when the contract was made, as liable to result from breach of contract

This is important because it helps in understanding why loss of profits for non-delivery or delayed delivery may be recovered when the party in breach could have reasonably contemplated that it was a serious possibility that such a loss could have occurred



Look at this example

> ***Victoria Laundry v. Newman Industries (1949)***
>
> V bought a boiler from N to use in his laundry. Delivery was to be made on June 5 but was not made until November 8. V claimed (1) loss of the profit the laundry would have made had the boiler been delivered in time; (2) loss of profit from some highly profitable dyeing contracts.
>
> **HELD**: (1) the laundry profit loss were recoverable, as N must have contemplated their loss if there was delay, but (2) the loss on dyeing contracts, which could not have been contemplated, could not be recovered.

#5 if the loss doesn't naturally arise from the breach, and yet such loss may be supposed to have been in contemplation of both parties at the time they contracted as the probable result of the breach of it, the injured party may recover

Remember as part of **managing contractual risks** it is a wise move to communicate the nature of unusual losses or damages likely to be sustained in a contract before you make the contract, this way you contract subject to the **prospective liability**.

#6 the breach of contract must be the proximate cause of the loss or damages.

Supposing the loss or damage is as a result of another event, for instance, the claimants own negligence, **the chain of causation is broken**

#7 Duty to mitigate the loss

It is the duty of the injured party to take reasonable steps to minimize damages. According to Lord Haldane in ***British Westinghouse Electric and manufacturing CO v Underground electric railway*** (1912) "the fundamental basis is compensation for pecuniary loss naturally flowing from the breach; but this **first principle** is qualified by a **second**, which imposes on a plaintiff the duty of taking all reasonable steps to mitigate the loss consequent on the breach and debars him from claiming any part of damages which is due to his neglect to take such steps"

Conclusion

The answer to the question how to calculate damages in a contract can be summed up with the answers to following six questions;

1. Has the claimant suffered any loss?
2. Is the loss suffered actionable?
3. Did the breach of contract cause the loss?
4. Was the type of loss reasonably foreseeable?
5. Did the claimant mitigate the loss?
6. Did the claimant contribute to the loss?

LIQUIDATED DAMAGES IN A CONTRACT

A large manufacturing company has begun a project to increase the size of their premises. The procurement team has estimated that if the main supplier fails to complete the project on schedule it will incur cost and losses of $20,000 per day for every day there is a delay

Which is the best way to put this as a clause in a contract with the supplier? Liquidated damages, that's how.

What are liquidated damages in a contract?

At times the parties to a contract may agree, during the formation of a contract that in the event of a breach, the damages shall be a fixed sum or shall be calculated in a specific manner. Such kind of damages is referred to as **liquidated damages**, that is, the monetary compensation amount that has been specifically agreed to by the parties privy to the contract.

RELATED: understanding the doctrine of privity in contracts (**WATCH NOW**)

If the parties do not have such a clause in their contract then what will happen in case of a breach is **unliquidated damages**. This means how much one is compensated will be left for the courts to decide. **The thing to note** about liquidated damages is that one only pays what they agreed to, assuming the damages are legit.

For instance

> ***Cellulose acetate Silk Co v. Widnes Foundry (1933)***
>
> W agreed to erect a plant for C by certain date, and also agreed to pay £20 for every week they took beyond that date. They were 30 weeks late, and C claimed £5,850, which was their actual loss from the delay.
>
> HELD: W had only agreed to pay £20 a week for delay and were not liable for more.

Liquidated damages and penalties

When a contact states that, on a breach, a fixed amount of money is to be paid by the responsible party, the question is whether this amount is a penalty or liquidated damages. The need to distinguish these two is important because if it is a **penalty** then actual damages suffered can be claimed, while if it is **liquidated damages** the sum fixed can be recovered.

The rules for distinguishing a penalty from liquidated damages are:

#1 the fact that you have used the word "penalty" or "liquidated damages" in a contract is not conclusive. Courts will have to decide should there be an issue

#2 the idea behind penalty is the payment of money stipulated as ***in terrorem*** (in terror, threat) of the offending party. This is to say, **the intent is to compel the performance** of the contract by providing something by way of punishment if the contract is not performed. This differs from liquidated damage, which is **a genuine pre-estimate of the loss**.

#3 if the amount stipulated is bigger than the greatest loss that could be conceivably proved to have followed from the breach, then the amount is liquidated damages.

For instance:

> ***Lamdon Trust Ltd v Hurrell (1955)***
>
> Under a hire purchase agreement in respect of a motor car the purchase price was £558, H paid a deposit and four instalments amounting to £ 302, but failed to pay the fifth instalment. L terminated the agreement, retook possession of the car and sold it for £270. L claimed £122 under a clause making H liable to pay in respect of "depreciation" a sum sufficient to bring his total payments up to £425 which was approximately three-quarters of the purchase price.
>
> HELD: the sum of £425 was not a genuine pre-estimate of damage but was an extravagant and extortionate sum held *in terrorem* over the head of the hirer. It was a penalty and as such not recoverable

#4 if the breach is as a result of not paying a given amount by a given time, and the fixed amount you are to pay in the event of this breach is greater than the actual amount you did not pay, then the fixed amount is a penalty.

For example:

John agrees to pay Cate £425 on June 1, and, if he fails to make the payment at the stipulated time, he is to pay £500 as liquidated damages. The extra £75 will be a penalty and irrecoverable.

 # 5 when a single sum is made payable on the occurrence of one or more of several events, some of which may occasion serious and others trifling damage, there is a presumption (but no more) that the sum is a penalty

Example

> ***Kemble v Farren (1829)***
>
> Farren agreed to act at Kemble's theatre and to conform to all the regulations of the theatre. Each party agreed on breach by either of them of the agreement to pay £1,000 as liquidated damages. Farren broke the contract, and the jury assessed the damages at £750.
>
> HELD: the £1,000 was a penalty because it was payable even if Farren had broken any of the smallest regulations of the theatre, and Kemble could only recover £750.

#6 A clause providing that in case of actual loss suffered by another party, another party shall indemnify the first-named party for the loss is not a penalty clause

Cheers!

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