

**JULY 2019 MEE**  
**QUESTION 4—CONTRACTS**

On March 1, a contractor and an owner of movie theaters signed an agreement providing that, no later than August 15, the contractor would install seats in the owner's new movie theater. The agreed-upon price was \$100,000, which was less than the \$150,000 that other similar contractors would charge for the same work. The agreement required that the owner pay the contractor half the price at the time the work commenced and the other half at completion. The contractor was willing to do the work for less money than its competitors because the contractor was new to the area and hoped to build up a positive reputation.

The agreement further provided that the contractor would start work no later than July 1. On July 1, before beginning the agreed-upon work, the contractor informed the owner that it would not perform its obligations under the agreement because it had obtained a more lucrative installation contract elsewhere. At that point, no payments had been made to the contractor.

The installation of the seats was the last step necessary for the theater to open to the public. The owner, which had anticipated that the contractor would install the seats by the August 15 deadline, had planned and widely promoted a film festival for September 1–10 to celebrate the opening of the new movie theater.

Immediately after learning that the contractor would not install the seats, the owner began to look for a substitute contractor. Despite diligent efforts, the owner could not find a contractor that would agree to install the seats by August 15. Eventually, after an extensive search, the owner found a substitute contractor that agreed to install the seats for \$150,000 by September 15. No other contractor could be found who would agree to install the seats at a lower price or before September 15.

Installation of the seats was completed on September 15, the substitute contractor was paid \$150,000, and the theater opened a few days later. Because the theater had no seats at the time of the film festival scheduled for September 1–10, the owner canceled the festival.

The owner sued the original contractor for breach of contract, and the parties agreed to a non-jury trial. The judge has concluded that the contractor's actions with respect to the seat-installation agreement constituted a breach of contract by the contractor. In addition, the judge has made the following findings of fact:

- The contractor was unaware that the owner was planning to hold a film festival when it entered into the contract.
- The owner would have made a profit of \$35,000 if the seats had been installed in the new movie theater and the film festival had been presented there as scheduled on September 1–10.
- The owner could have relocated the film festival to a nearby college auditorium that was available September 1–10 and, if this had occurred, the owner would have made a profit of \$25,000.

1. Do the damages recoverable by the owner include \$50,000 for the amount paid to the substitute contractor above the \$100,000 price to be paid to the original contractor under the contract? Explain.
2. May the owner recover for lost profits resulting from the cancellation of the film festival? Explain.
3. Assuming that the owner is entitled to recover for lost profits resulting from the cancellation of the film festival, how much should the owner recover? Explain.

## Question Presented

A contractor agreed to install theater seats by August 15 for \$100,000. On July 1 the contractor repudiated (it took a better job). The owner searched diligently and the only substitute would install by September 15 for \$150,000.

← cover:  $\$150k - \$100k = \$50k$   
direct/expectation damages

The owner had promoted a film festival for September 1 to 10 to open the theater; with no seats installed, the owner canceled it.

← consequential loss = the lost festival profits

The judge found the contractor was unaware of the film festival when it contracted, and nothing shows it had reason to know.

← foreseeability: unforeseeable when the contract was made

Findings: festival profit would have been \$35,000; the owner could have moved it to an available college auditorium and made \$25,000.

← mitigation: \$25k avoidable → only \$10k unavoidable

But a purpose of the festival was to showcase the new theater, so the auditorium may not have been a reasonable substitute.

← if relocation isn't reasonable → no reduction, recover \$35k

1. Do damages include the \$50,000 paid to the substitute above the \$100,000 contract price?

← → expectation / cover

2. May the owner recover lost profits from the canceled festival?

← → foreseeability (consequential)

3. If so, how much?

← → mitigation / avoidability

## Question 1: Direct (Expectation) Damages

**Issue.** Whether the owner's damages include the \$50,000 it paid the substitute above the original \$100,000 price.

Recover the extra cover cost?

**Rule.** Contract damages protect the injured party's expectation interest, putting it in as good a position as if the contract had been performed. When a contractor breaches, the injured party may

Expectation interest; direct damages = cover price – contract price.

cover by procuring substitute performance and recover the difference between the cover price and the contract price.

**Analysis.** Here, the owner would have paid \$100,000 but had to pay the only available substitute \$150,000, so it is \$50,000 worse off than if the contractor had performed. That \$50,000 is the direct measure.

**Conclusion.** Therefore, the owner may recover the \$50,000.

*\$150k paid – \$100k contract = \$50k.*

*Yes: \$50,000 recoverable.*

## Question 2: Consequential Damages and Foreseeability

**Issue.** Whether the owner may recover the lost film-festival profits as consequential damages.

**Rule.** Consequential damages are recoverable only if, at the time the contract was made, the breaching party had reason to foresee the loss as a probable result of a breach, either in the ordinary course of events or from special circumstances the breaching party had reason to know.

**Analysis.** Here, the court found the contractor was unaware of the festival, and nothing shows it had reason to know; a canceled festival does not follow in the ordinary course from a failure to install theater seats. So the loss was not foreseeable when the contract was made.

**Conclusion.** Therefore, the owner most likely cannot recover the festival lost profits.

*Are the festival losses recoverable at all?*

*Consequential damages must be foreseeable when the contract was made (ordinary course or known special circumstances).*

*Contractor didn't know and had no reason to; not an ordinary-course result.*

*Probably not recoverable (unforeseeable).*

## Question 3: Mitigation / Avoidability of Loss

**Issue.** Assuming the festival loss was foreseeable, how much of the \$35,000 the owner may recover given the option to relocate.

**Rule.** An injured party cannot recover for loss it could have avoided by reasonable efforts. Loss avoidable by making a reasonable substitute arrangement is subtracted from recovery, unless avoidance would impose undue risk, burden, or humiliation, or the substitute would not have been reasonable.

**Analysis.** Here, the owner could have moved the festival to an available auditorium and made \$25,000, cutting the loss to \$10,000; if that was a reasonable substitute, recovery is limited to \$10,000. But because a primary purpose was to showcase the new theater, the auditorium may not have been a reasonable substitute,

*How much survives the duty to mitigate?*

*Subtract avoidable loss (reasonable substitute), unless undue burden or the substitute is unreasonable.*

*Auditorium avoids \$25k → \$10k left; but if the point was to showcase the theater, relocation isn't reasonable → full \$35k.*

in which case the failure to relocate does not reduce recovery.

**Conclusion.** Therefore, the owner recovers \$10,000 if relocation was a reasonable substitute, or the full \$35,000 if showcasing the new theater made relocation unreasonable.

*\$10,000 or \$35,000, depending on whether the auditorium was a reasonable substitute.*

## Step-by-Step: Contract Damages

*Start with the expectation interest, then test any special loss for foreseeability and for avoidability.*

**1. Expectation interest: put the injured party where full performance would have. Direct damages = cover (substitute) price – contract price.**

→ **Q1: \$150k – \$100k = \$50k**



**2. Consequential (special) damages: foreseeable when the contract was made (ordinary course OR special circumstances the breacher had reason to know)?**

→ Not foreseeable: **NOT recoverable.** **Q2: contractor unaware → not recoverable**

→ Foreseeable: continue.



**3. Mitigation / avoidability: subtract loss the injured party could reasonably have avoided (a reasonable substitute), unless undue burden or the substitute is not reasonable.**

→ Reasonable substitute available → recover only the unavoidable loss (\$10k).

→ Substitute not reasonable (showcase the new theater) → recover the full \$35k. **Q3: depends**