"Breach of Contract" and "Defenses to Contract and Excuses for Breach"
Excerpts from *Business Law Basics*

18.4 Breach of Contract

When a party fails to live up to its obligations under the contract, he is said to have **breached** the agreement or to be **in breach of contract**. The party harmed by this breach may sue to recover damages. Courts generally refer to some basic principles in determining what sort of damages a party may recover. First, courts prefer that damages be monetary rather than to order **specific performance**, or force a party to go through with its contractual obligations. Second, judicial relief is intended to compensate the promise, putting the party back in the position he would have been if the breach had not occurred and the contract had been fulfilled. In addition, contract law is primarily intended to provide relief to the party harmed by the breach, *not* to punish the breaching party. Thus, **punitive damages**, or damages intended to deter certain types of behavior through additional monetary penalties, are not usually recoverable in a contract dispute. Sometimes, a party can prove a breach of contract, but cannot prove damages with any reasonable degree of certainty. In such cases, a court may grant **nominal damages**, such as $1, in recognition of the harm caused by the breach.

The exact type of damages granted by a court depends on the situation. Contract damages normally fall within three basic categories:

Expectation damages. A party can recover expectation damages if he is worse off by reason of the breach than he would have been if the contract had been performed. Expectation damages are designed to place the promise in the position he would have been in if the promise had been performed.[1] For example, Party A contracts to sell 100 pounds of coffee beans to Party B for $200. Party B has a buyer who will pay him $300. Party A breaches. The measure of Party B's expectation damages is $100, or the $300 Party B would have received in sale minus the $200 he would have paid for the goods.

Reliance damages. A party may recover reliance damages if the breach of contract has left him worse off than he would have been if the promise had never

[1] *Hawkins v. McGee*, 146 A. 641 (N.H. 1929).

been made—for example, where a party has relied on a promise and suffered reasonably foreseeable expenses as a result of the promise. Reliance damages are generally limited to out-of-pocket expenses incurred, but opportunity costs may also be recoverable.[2] Suppose that in the example above, Party B had informed Party A that he was building a storage unit for the coffee beans at a cost of $100. He also passed up an opportunity to purchase similar goods at a slightly higher price. Party B may be able to recover the cost of building the storage unit as reliance damages; furthermore, he may be able to recover the opportunity cost of procuring similar goods from another source.

Restitution damages. Where a party has conferred a benefit on the breaching promisor, he may recover the reasonable value of the benefit provided.[3] Returning to our coffee merchants, suppose that Party B paid Party A $100 up front. This advance payment would be recoverable as restitution damages.

Specific performance. In certain limited cases, a court may order **specific performance**; that is, the court may order the breaching party to carry out fully its contractual obligations.[4] This type of remedy is usually only available when the item involved is unique, such as real estate, or where monetary damages would be impossible to determine.[5]

18.5 Defenses to Contract and Excuses for Breach

Certain acts or circumstances may cause a contract to be void *ab initio* (from its inception) or voidable at some defined point in time. These are called **defenses to contract** because they can be raised by the defendant in a breach of contract lawsuit as reasons why the court should not enforce the agreement at issue. In other cases, a party may have its performance of contractual obligations **excused** or **discharged** (eliminated by some intervening event).

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[2] *Sullivan v. O'Connor*, 296 N.E.2d 183 (Mass 1973).
[3] *Osteen v. Johnson*, 473 P.2d 184 (Colo. App. 1970).
[4] Restatement (Second) of Contracts §§ 359-360.
[5] *London Bucket Co. v. Stewart*, 237 S.W.2d 509 (Ky. 1951).

Illegality and unconscionability. A contract is void if it requires the performance of an act that violates a relevant law, such as a statute or regulation. A court may also refuse to enforce a contract that contains **unconscionable** elements, or terms that would lead to a result that offends justice. In such a case, a court may choose to enforce the contract in a limited way that avoids an unconscionable result.[6]

Duress and undue influence. All contracts involve some degree of threat, such as the threat of a failed business deal. It is difficult to tell where exactly a court will draw the line between legitimate threat and undue duress. Generally, however, threats to engage in legal activity (such as filing a lawsuit or publicizing another party's conduct) do not constitute duress. Contracts made under duress are voidable by the party against whom certain types of threats are made.[7] Undue influence is a related concept, which occurs when one person takes advantage of another's mental state or his knowledge of another's personal weaknesses to impair free will and induce the formation of an unfair contract. Bereavement and lack of sophistication are examples of situations where one party may end up being unduly influenced by another.[8]

Misrepresentation or fraudulent inducement. If a party can demonstrate that a contract was the result of **fraudulent inducement** by the other party (i.e., the party was induced to enter into the contract by false information or the withholding of information that the other party was under a duty to disclose), the contract is voidable by the defrauded party.

Public policy. Certain types of contracts are considered **void for public policy**; that is, they are legally unenforceable because the subject matter of the contract, while legal, is something in which courts choose not to involve themselves or that the courts have held are in opposition to the public good. For example, in many jurisdictions agreements for surrogate parenting, in which a woman promises to conceive, bear, and deliver a child to another person or couple, are void for public

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[6] *Weaver v. American Oil Co.*, 276 N.E.2d 144 (Ind. 1971).

[7] Restatement (Second) of Contracts §§ 175-176.

[8] Restatement (Second) of Contracts § 177(2); *McAllister v. Schettler,* 521 A.2d 617 (Del. Ch. 1986).

policy reasons.[9] Some jurisdictions forbid contracts which give up the right to bring certain types of lawsuits. Because cultural and societal norms can vary greatly between jurisdictions (California, West Virginia, and Guam, just to name a few, have drastically different social norms), public policy of different states, and the types of contracts that are void thereunder, can differ widely.

Misunderstanding. A **misunderstanding** may prevent the creation of a contract where it is sufficiently severe that the parties do not have the same understanding of the contract's material terms.[10] Suppose that Party A agrees to pay Party B $5000 for Party B's "car." Party B has two cars, a Honda and a Ford. Party A intends to purchase the Ford, but Party B believes they are contracting for the Honda. No contract has been created. An exception, however, is where one party has knowledge of the other party's interpretation, but does not reveal his own, different interpretation, a court may enforce the interpretation of the ignorant party. Thus, in the situation above, if Party B knows full well that Party A means the Ford, and Party A does not know that Party B means the Honda, the court will likely enforce the sale of the Ford.[11]

Mistake. Related to the concept of misunderstanding is that of mistake. There are two types of mistake. The first is **mutual mistake**, where parties enter into a contract while both of them are mistaken about the same basic set of facts. Generally, a contract resulting from mutual mistake is voidable by the adversely affected party.[12] For example, Party A agrees to sell Party B a cow that both believe to be infertile. Party A then discovers that the cow is, in fact, pregnant, and thus much more valuable than either party believed. Party A may rescind the contract due to this mutual mistake.[13] The other type of mistake is **unilateral mistake**, where one party uses words that are clear and unambiguous but has made a mistake of fact that, had he been aware of it, would have caused him to express himself differently. A typical case

[9] *In re Baby M.*, 537 A.2d 1227 (N.J. 1988).
[10] Restatement (Second) of Contracts § 20.
[11] Restatement (Second) of Contracts § 201.
[12] Restatement (Second) of Contracts § 152.
[13] *Sherwood v. Walker*, 33 N.W. 919 (Mich. 1887).

is where a party makes a simple error in mathematical calculation, and offers a purchase price based on his miscalculation. Whether unilateral mistake will void the contract depends on whether the other party to the contract was aware of the mistake or not. If the other party was so aware, or whether a reasonable person in its position would have been aware, then the contract is generally void; if, however, he had no reasonable way of being aware of the mistake, the contract is enforceable.[14]

Impossibility. Performance of a valid contract is excused where facts that a party did not cause, and could not reasonably have anticipated, intervene to make performance objectively impossible. **Objective impossibility** is where such an event has made performance impossible by anyone. **Subjective impossibility** is where performance is made impossible only for the specific party involved. Courts have held that only objective impossibility discharges the duty to perform. Some examples include where a change in the law or act of government make performance illegal, where the subject matter of the contract is destroyed by supervening event, or where a person promising to perform services dies or becomes seriously ill.[15] An intervening event that makes performance more expensive or difficult, on the other hand, does not amount to impossibility, even if performance becomes unprofitable.[16]

Frustration of purpose. A contractual obligation may also be discharged where the purpose or value of the contract has destroyed the value of performance for all parties, thus causing a **frustration of purpose** of the contract.[17]

[14] *Elsinore Union Elementary School District v. Kastoroff*, 353 P.2d 713 (Cal. 1960).
[15] *E.g.*, *Taylor v. Caldwell*, 3 Best & S. 826 (1863).
[16] *Transatlantic Financing Corp. v. United States*, 363 F.2d 312 (D.C. Cir. 1966).
[17] *Krell v. Henry*, 2 K.B. 740 (1903).