

On March 1, a mechanic contracted to repair a textile company's knitting machine by March 6. On March 2, the textile company contracted to manufacture and deliver specified cloth to a customer on March 15. The textile company knew that it would have to use the machine then under repair to perform this contract. Because the customer's order was for a rush job, the customer and the textile company included in their contract a liquidated damages clause, providing that the textile company would pay the customer \$5,000 for each day's delay in delivery after March 15.

The mechanic was inexcusably five days late in repairing the machine, and, as a result, the textile company was five days late in delivering the cloth to the customer. The textile company paid \$25,000 to the customer as liquidated damages and then sued the mechanic for \$25,000. Both the mechanic and the textile company knew when making their contract on March 1 that, under ordinary circumstances, the textile company would sustain few or no damages of any kind as a result of a five-day delay in the machine repair.

Assuming that the \$5,000-per-day liquidated damages clause in the contract between the textile company and the customer is valid, which of the following arguments will serve as the mechanic's best defense to the textile company's action?

- A. By entering into the contract with the customer while knowing that its knitting machine was being repaired, the textile company assumed the risk of any delay loss to the customer.
- B. In all probability, the liquidated damages paid by the textile company to the customer are not the same amount as the actual damages sustained by the customer in consequence of the late delivery of the cloth.
- C. The mechanic had no reason to foresee on March 1 that the textile company would suffer consequential damages in the amount of \$25,000.
- D. Time was not of the essence in the contract between the mechanic and the textile company.

## Explanation:

### Consequential damages

Damages for losses stemming from nonbreaching party's special circumstances if breaching party:

knew of those special circumstances

OR

could have reasonably foreseen harm caused by breach

The primary goal of contract damages is to put the nonbreaching party in the same position as if the contract had been performed. This includes expectation damages for the value of the breaching party's performance that was lost. However, it includes **consequential damages** for losses arising from the nonbreaching party's **special circumstances** only if the breaching party:

**knew about** the nonbreaching party's **special circumstances** *or*

could have **reasonably foreseen the harm**, in light of the nonbreaching party's special circumstances, that would result from a breach.

Here, the mechanic was inexcusably five days late in repairing the knitting machine. Under normal circumstances, the textile company would have sustained *few or no* damages as a result of the breach. However, the textile company did not inform the mechanic of its contract with the customer. Therefore, the fact that the mechanic had no reason to foresee that the textile company would suffer \$25,000 in consequential damages (\$5,000 for each day's delay) is the mechanic's best defense.

**(Choice A)** The facts do not indicate that the textile company assumed the risk of any delay loss to the customer. The textile company had contracted with the mechanic for repairs to be completed within a time frame that would have allowed it to timely fulfill its contractual obligations to the customer.

**(Choice B)** The facts state that the liquidated damages clause is valid; they do not provide information concerning the actual damages sustained by the customer.

**(Choice D)** Although the contract did not state that time was of the essence, the mechanic agreed to complete the repairs by a specified time. His failure to do so constituted a breach entitling the textile company to damages. Nevertheless, the textile company cannot recover the \$25,000 because those damages were unforeseeable.

### Educational objective:

An award of consequential damages for losses arising from the nonbreaching party's special circumstances is appropriate only if the breaching party (1) knew about the special

circumstances or (2) could have reasonably foreseen the harm, in light of the special circumstances, that would result from a breach.

### **References**

Restatement (Second) of Contracts § 351 (Am. Law Inst. 1981) (unforeseeability and related limitations on damages).

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