A bank agreed to lend a merchant $10,000 for one year at 8% interest. The loan proceeds were to be disbursed within two weeks. The merchant intended to use the loan proceeds to purchase a specific shipment of carpets for resale at an expected profit of $5,000 but said nothing about these plans to the bank.

The bank failed to disburse the proceeds and refused to assure the merchant that it would do so. The merchant was able to secure a loan from another lender at 10% interest for one year. However, by the time the merchant started the application process for a substitute loan, it was too late to pursue the opportunity to buy the shipment of carpets.

In an action against the bank for breach of contract, which of the following amounts is the merchant likely to recover?

A. $5,000, the merchant's foreseeable loss.

B. Nothing, because damages for lost opportunities are not recoverable.

C. Nothing, because the parties failed to tacitly agree that the merchant would be entitled to damages in the event of a breach by the bank.

D. The difference in cost over time between a loan at 10% and a loan at 8%.

**Explanation:**

**Expectation (ie, benefit-of-the-bargain) damages**

| | |
|---|---|
| **Definition** | Losses arising naturally & obviously from breach |
| **Purpose** | Place nonbreaching party in same position as if contract had been performed |
| **Measure** | General rule – difference between contract price & market price (or cost of purchasing substitute performance)<br>Construction contracts – difference between contract price & cost of construction by another builder |

The primary goal of contract damages is to place the nonbreaching party in the same position as if the contract had been fully performed. This typically means that the **nonbreaching party can recover**:

**expectation damages** – losses arising naturally and obviously from the breach, which can be measured by the **difference between** the **contract price** and the **market price** *and/or*

**consequential damages** – losses arising from the **nonbreaching party's special circumstances** (eg, lost opportunities) that the breaching party could **reasonably foresee** when the contract was made.

The **"contract price" of a loan** is the **interest costs incurred** over the life of the loan. This means that if a lender breaches a loan agreement, the borrower can recover the difference between the interest cost of the original loan (contract price) and the interest cost of a substitute loan (market price). The merchant here can therefore recover expectation damages equal to the difference in cost over time between a loan at 10% and one at 8%.

**(Choices A & B)** A nonbreaching party can recover *consequential* damages for losses the breaching party could reasonably foresee at the time of contracting. But here, the bank knew nothing of the merchant's intent to purchase the carpets when the contract was entered. As a result, damages for the merchant's lost opportunity to purchase the carpets and lost profits ($5,000) are not recoverable. But the merchant may still recover *expectation* damages.

**(Choices C)** The tacit-agreement test considers (1) whether the parties contemplated a loss when the contract was made and (2) how they likely would have allocated that risk. Consequential damages would be awarded (or not) accordingly. However, the courts and the UCC have rejected this test.

**Educational objective:**

If a lender breaches a loan agreement, the borrower can recover expectation damages equal to the difference between the interest cost of the original loan (contract price) and the interest cost of a substitute loan (market price).

**UCC** = Uniform Commercial Code

**References**

Restatement (Second) of Contracts § 347 (Am. Law Inst. 1981) (measure of damages).