Problem 12-1

(a)

Expectation Damages

Michaels would first argue that she should be entitled to recover expectation damages. This computation can be subdivided into two parts: the lost income to date and the future lost income. Michaels began operations in January 2001. The facts state that she brought suit in "late 2002." For ease of computation I will assume the business had been in operation for two years. The company projected that Michaels would receive an average annual net profit of $75,000 plus an owner's salary of $50,000. Instead, Michaels only received $20,000 in salary. Thus, Michaels has suffered a "loss in value" of $105,000 for each of the first two years. Big Burger might argue that Michaels cannot prove these damages with reasonable certainty. However, this argument may be especially difficult for it to sustain because the figures being used were ones supplied by the company itself. Michaels does not appear to have any "other loss"; she did not incur consequential damages because of the breach of contract by Big Burger. There would be no "cost avoided" to subtract from this sum because these are net profit figures; all costs have already been taken into account.

In addition Michaels expected to receive a stream of income of $125,000 per year into the future (consisting of net profit plus owner's salary). While Big Burger might argue that these damages are too speculative to be recovered, Michaels's response will be the same as above: These are the figures that Big Burger itself supplied. Michaels does not appear to have any other loss or cost avoided. However, she would be able to avoid some of the loss by taking other employment. Big Burger would have the burden of proving that Michaels could obtain comparable employment. Recall the notes after the Boehm v. American Broadcasting Co. case in Chapter 11. Big Burger might plausibly argue that Michaels could obtain a job similar to the one she had before she became a franchisee, at a salary of $25,000 per year. If this claim is accepted, Michaels will have a projected annual loss of $100,000 per year.

The standard technique for converting a projected stream of earnings into a lump sum value is by using an "earnings multiple." Expert testimony would be necessary to establish an appropriate multiple for this business. An expert would take into account factors such as the going interest rate, the earnings history of the business, and the earnings multiples for comparable businesses. By way of comparison, the current average earnings multiple for companies listed on the New York Stock Exchange is typically between 15 and 20. These companies are, of course, much less risky than this franchise, so they would command much greater multiples. Considering this comparison, a multiple of perhaps 5 would be appropriate for Michaels's franchise. Using this figure, the business would have a lump sum value of $500,000.

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Michaels would have little chance of recovering her attorney fees, punitive damages, damages for emotional distress, or prejudgment interest. Unless the contract provided for attorney fees, the situation does not seem to fall within any of the exceptions to the American Rule. In particular, there is no evidence of bad faith conduct on Big Burger's part, only an ordinary breach. Punitive damages are not generally recoverable unless the breach of contract amounts to a tort. Restatement (Second) §355. Perhaps Michaels could argue that Big Burger engaged in fraud in connection with the financial statements. If so punitive damages might be awarded. Damages for emotional distress in contract actions are not generally awarded when the contract is purely commercial in nature, rather than having personal elements. Recall Erlich v. Menezes, in Chapter 11; see also Restatement (Second) §353. Here the contract appears to be purely commercial. Prejudgment interest may be recovered if the damages are liquidated, a fixed or readily ascertainable sum. Damages for lost profits do not seem to fit this requirement because the amount and valuation are matters of judgment, not fixed determination.

Big Burger might claim that Michaels's recovery should be reduced by the reasonable resale value of the equipment, arguing that she has a duty to mitigate her damages by disposing of this equipment. However, if the cost of the equipment has been amortized in determining projected net profits then this deduction should not be made; doing so would give Big Burger a double reduction for the cost of the equipment. Note that Michaels could not recover her expenses incurred in obtaining and operating the franchise. This would be a double recovery because these expenses had to be incurred for her to obtain this profit.

Reliance Damages

If a court concludes that Michaels is not entitled to recover expectation damages because those damages are too speculative, she would still be entitled to recover reliance damages. Wartman v. Hightower Productions, Ltd., page 925; Restatement (Second) §349. Reliance damages include expenses in preparation for, or in part performance of, a contract, the amount of income forgone to enter into the contract, and expenses of incidental reliance.

(a) Preparation or part performance:

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Franchise fee</td>
<td>$100,000</td>
</tr>
<tr>
<td>Equipment</td>
<td>50,000</td>
</tr>
</tbody>
</table>

The reasonable resale value of the equipment should be deducted from Michaels's recovery because reliance damages should be reduced by the cost of mitigation. Assuming that the equipment could be resold for 50% of cost, damages would be reduced by

(25,000)

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Michaels might also try to recover her legal and traveling expenses incurred before the contract. This might pose a problem; Big Burger could argue that expenses incurred before making the contract cannot be in reliance on the contract. On the other hand, the expenses were incurred in contemplation of the contract and were foreseeable by Big Burger.

15,000

(b) Forgone opportunities:

Michaels gave up a job in which she was earning $25,000 per year. In her franchise operations she received only $20,000 per year in salary, resulting in a net loss to her of $5,000 per year. A court might award some amount to compensate her for lost income until she obtains another job. I assume that she was involved in the franchise business for two years and that she is able to quickly obtain a job comparable to the one she had before she entered the franchise business.

10,000

(c) There do not appear to be any incidental reliance damages involved in the case.

Total reliance damages $150,000

As was the case with expectation damages, it appears unlikely that Michaels could recover attorney fees, punitive damages, damages for emotional distress, or prejudgment interest.

Restitutionary Damages

A nonbreaching party may elect to recover restitutionary damages for breach of contract rather than either expectation or reliance damages. United States ex rel. Coastal Steel Erectors, Inc. v. Algernon Blair, Inc., page 942; Restatement (Second) §373. Restitutionary damages for breach of contract are generally measured by the fair market value of the performance. The amount of restitution is reduced by the value of any benefits that the plaintiff received under the contract. Here the fair market value of Michaels's performance was $100,000, the cost of the franchise. For two years she received $20,000 in salary. Thus, her net recovery in restitution would be $60,000. Michaels also paid Big Burger rental for the restaurant and a percentage of sales. I assume, however, that these amounts were taken into account in determining net profits. Thus, these expenses were “washed out” by the income that she received to pay these sums to Big Burger.
The lawyer should elect damages rather than rescission. Generally an award of expectation or reliance damages includes protection of the restitutinary interest. Election of restitutinary damages will normally be advantageous only when the contract would be a losing one. Recall Algernon Blair. In this case Michael's expectation damages would be more than $700,000, her reliance damages would be $150,000, and her restitutinary damages only $60,000.