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VII. Limitations on Damages

The law imposes four important limitations on a plaintiff’s ability to recover losses as damages: (1) a plaintiff must prove its damages with reasonable certainty, (2) a plaintiff may not recover damages that are too remote, (3) a plaintiff has a duty to mitigate its damages, and (4) a liquidated damages clause may limit the amount of damages by prior agreement.

A. Is the Defendant Arguing That Plaintiff’s Damages Estimate Is Too Uncertain and Speculative?

In general, damages law holds that a plaintiff may not recover damages beyond an amount proven with reasonable certainty. This rule permits damages estimates that are not mathematically certain but excludes those that are speculative. Failure to prove damages to a reasonable certainty is a common defense. The determination of what constitutes speculation is increasingly a matter of law to be determined prior to trial in a Daubert proceeding.

Courts and commentators have long recognized the difficulties in defining what constitutes reasonable certainty or speculation in a damages analysis. The exclusion of damages on grounds of excessive uncertainty regarding the amount of damages may result in an award of zero damages when it is likely that the plaintiff suffered significant damages, even though the actual amount is quite uncertain.

There are three contexts in which reasonable certainty or speculation can arise: (1) where the outcome is uncertain, (2) where it is argued that the expert has not used the best method or data, or (3) where the damages suffered by a specific plaintiff are uncertain.

Traditionally, damages are calculated without reference to uncertainty about outcomes in the but-for scenario. Outcomes are taken as actually occurring if they are the expected outcome and as not occurring if they are not expected to occur. This approach may overcompensate some plaintiffs and undercompensate others. For example, suppose that a drug company was deprived of the opportunity to bring to market a drug that had a 90% chance of receiving Food and Drug

52. See, e.g., Restatement (Second) of Contracts § 352 (“Damages are not recoverable for loss beyond an amount that the evidence permits to be established with reasonable certainty”).

53. Comment a to Restatement (Second) of Contracts § 352 states, in pertinent part: “Damages need not be calculable with mathematical accuracy and are often at best approximate.”

54. See, e.g., Cole v. Homier Distributing Co., Inc., 599 F.3d 856, 866 (8th Cir. 2010) (expert testimony on lost profits excluded under Daubert standard because it “failed to rise above the level of speculation”). See also Webb v. Braswell, 930 So. 2d 387 (Miss. 2006). In Webb, the plaintiff’s expert sought to testify as to future damages resulting from unplanted crops, without establishing that the crops would have been profitable. The court excluded the testimony based on Mississippi’s adoption of the Daubert standard, stating that “damages for breach of contract must be proven with reasonable certainty and not based merely on speculation and conjecture.” Id. at 398.
Administration (FDA) approval, at a profit of $2 billion, and a 10% chance of not receiving FDA approval, with losses of $1 billion. The court may treat 90% as near enough to certainty and ignore the 10% risk of failure and award damages of $2 billion.

By contrast, economists quantify losses of uncertain outcomes in terms of expected values, where the value in each outcome is weighted by its probability. Under that approach, economic losses in our example should be calculated as the $2 billion economic loss assuming FDA approval times 90% plus the $1 billion economic loss times 10%, or (0.9) × ($2 billion) + (0.1) × (−$1 billion) = $1.7 billion. The plaintiff would be overcompensated by $300 million under the approach that ignored the small probability of failure.

Now suppose the drug has only a 40% chance of FDA approval with the same economic payoffs. The plaintiff may recover no damages on grounds of uncertainty and speculation even though the economic loss is (0.4) × ($2 billion) + (0.6) × (−$1 billion) = $200 million. This issue also arises with respect to new businesses and is discussed further in Section VIII.A.

The second context where speculation arises when a damages expert fails to conduct his analysis in accordance with the principles discussed in Daubert.55

In general, the expert should provide all available information about the degree of uncertainty in an estimate of damages particularly when the claim is that inadequate data are available.

Example: A fire destroyed Broker’s business including its business records. Defendant Smoke Detector Manufacturer argues that determining the profitability of the Broker’s business is impossible without the business records. Therefore, damages are speculative and damages should not be awarded. Broker argues that the information would have been available absent the failure of Smoke Detector Manufacturer’s product, and so Broker should be permitted wide latitude to measure damages from fragmentary records.

This issue also arises in labor cases where the defendant has failed to maintain the records as required by law.

Example: A class of workers was denied lunch breaks as required by state law. The class estimates damages assuming that no lunch breaks were ever taken. Defendant Can Maker argues that lunch breaks were often taken and provides testimony by a few employees as proof. The class argues that it is entitled to damages on the hypothesis that no lunch breaks were ever taken because Can Maker failed to keep proper records.

55. See Margaret A. Berger, The Admissibility of Expert Testimony, in this manual.
Disputes about what constitutes a reasonable damages analysis can range from the plaintiff’s assertion that lack of records entitles it to damages under the worst-case scenario to defendant’s assertion that damages are zero because any calculation is speculative. Furthermore, the latitude afforded the plaintiffs sometimes appears to depend on the egregiousness of the defendants’ improper actions. The difficulties in finding a middle ground are greater when the defendant fails to make an affirmative estimate of damages but only attacks the plaintiff’s quantification as speculative. Defendants frequently avoid offering a jury an affirmative damages analysis for fear that the jury will take the affirmative analysis as a concession of fault.

The question of speculative damages also arises in a third context when the certainty of damages for a specific plaintiff is not knowable at the time of trial.

Example: Vaccine Maker’s duck flu vaccine given to children has been proven to harm one-quarter of the children who receive it, but determining which children will be affected is impossible. The harm is the onset of dementia at age 50, with economic losses of $1 million per person. Trial occurs well before any of the vaccinated children has reached this age. The expert for the class measures damages as $250,000 per recipient of the vaccine. The expert for Vaccine Maker argues that damages are zero because it is more likely than not that any given child was not harmed.

Comment: The class might not recover damages even though the average class member’s economic loss is the expected value of $250,000. The case might be resolved at an early stage by denial of class certification because it is not possible to define a class in which all members were proven to be harmed.\(^\text{56}\) Note that a possible solution would be to create a trust with $250,000 per class member, let it earn market returns, and pay out that amount plus the returns to each class member who develops dementia.

This difficulty in determining the probability of damages may be part of a challenge to class certification and is discussed further in Section XI.

B. Are the Parties Disputing the Remoteness of Damages?

A second legal limitation on damages is that a plaintiff may not recover damages that are too remote. In tort cases, this restriction is expressed in terms of proximate cause,\(^\text{57}\) which often is equivalent to reasonable foreseeability. In contract

\(^{56}\) See, e.g., \textit{In Re New Motor Vehicles Canadian Export Antitrust Litig.}, 522 F.3d 6 (1st Cir. 2008).

cases, the limitation is similarly embodied in the idea of foreseeability—a party may not recover damages that were not reasonably foreseeable by the parties at the time of the agreement. The foreseeability rule has two parts. First, a party is liable for what are known as direct or general damages—those damages that arise naturally from the breach itself. Second, a defendant may also be liable for consequential or special damages—damages apart from those arising naturally from the breach—if such damages were reasonably foreseeable at the time of the agreement. Although sometimes there are differences between proximate cause in torts and foreseeability in contracts, the general concept is the same: The law imposes a limit on damages that are too remote.

The rule is often at issue in cases in which the injured party’s loss greatly exceeds the benefit the breaching party received in return.

Example: Manufacturer hires Repairman to replace a part in a machine in its plant. Repairman negligently performs the service, causing Manufacturer’s plant to cease production for two weeks. Manufacturer’s damages demand includes a claim for two weeks of lost profits. Repairman counters that, although he may be liable for the cost of proper repairs, the foreseeability rule bars a claim for lost profits because such damages were not a probable consequence reasonably foreseeable at the time of the agreement.

Similar examples involve cases in which a package delivery firm or courier service is sued for remote consequential damages resulting from its failure to deliver a package.

These limitations on damages are closely related to mitigation and the proper protection from losses resulting from the failure of agents or counterparties. A responsible company would not risk large losses from the failings of a repairman or delivery service. Rather, the company would use redundancy or other standard measures to limit the chances that such a failure would cause huge losses.

C. Are the Parties Disputing the Plaintiff’s Efforts to Mitigate Its Losses?

A third limitation on damages is that a party may not recover for losses it could have avoided, and is often expressed by stating that the injured party has a duty to mitigate, or lessen, its damages. The economic justification for the mitigation rule

58. See E. Allan Farnsworth, Legal Remedies for Breach of Contract, 70 Colum. L. Rev. 1145, 1199–1210.
59. Id.
is that the injured party should not cause economic waste by needlessly increasing
its losses.62

In a dispute about mitigation, the law places the burden of proof on the
defendant to show that the plaintiff failed to take reasonable steps to mitigate.63
The defendant will propose that the proper offset is the earnings the plaintiff should
have achieved, under proper mitigation, rather than actual earnings. In some cases,
the defendant may presume the ability of the plaintiff to mitigate in certain ways
unless the defendant has specific knowledge to the contrary at the time of a breach.
For example, the defendant might presume that the plaintiff could mitigate by
locating another source of supply in the event of a breach of a supply agreement.
Damages are limited to the difference between the contract price and the current
market price in that situation.

For personal injuries, the issue of mitigation often arises because the defendant
believes that the plaintiff’s failure to work after the injury is a withdrawal from
the labor force or retirement rather than the result of the injury.64 For commer-
cial torts, mitigation issues can be more subtle. Where the plaintiff believes that
the harmful act destroyed a company, the defendant may argue that the company
could have been put back together and earned profit, possibly in a different line
of business.65 The defendant will then treat the hypothetical profits as an offset
to damages.66

Alternatively, where the plaintiff continues to operate the business after the
harmful act and includes subsequent losses in damages, the defendant may argue
that the proper mitigation was to shut down after the harmful act.67

Example: Franchisee Soil Tester starts up a business based on Franchiser’s propri-
etary technology, which Franchiser represents as meeting government
standards. During the startup phase, Franchiser notifies Soil Tester that
the technology has failed. Soil Tester continues to develop the busi-
ness but sues Franchiser for profits it would have made from successful
technology. Franchiser calculates much lower damages on the theory
that Soil Tester should have mitigated by terminating the startup.

62. See E. Allan Farnsworth, Legal Remedies for Breach of Contract, 70 Colum. L. Rev. 1145,
1183–84.
63. See, e.g., Broadnax v. City of New Haven, 415 F.3d 265, 268 (2d Cir. 2005) (defendant
employer seeking to avoid a claim of lost wages bears the burden of proving that the plaintiff failed to
mitigate his damages by, among other things, taking reasonable steps to obtain alternate employment).
64. See William T. Paulk, Commentary, Mitigation Through Employment in Personal Injury Cases:
The Application of the “Reasonable” Standard and the Wealth Effects of Remedies, 58 Ala. L. Rev. 647–64
(2007).
65. See Seahorse Marine Supplies v. Puerto Rico Sun Oil, 295 F.3d 68, 84–85 (1st Cir. 2002).
66. Id. at 84.
67. Id. at 85. Also see In re First New England Dental Ctrs., Inc., 291 B.R. 240 (D. Mass. 2003).
Comment: This is primarily a factual dispute about mitigation. If the failure of the technology was unambiguous, it would appear that Soil Tester was deliberately trying to increase damages by continuing its business. On the other hand, Soil Tester might argue that the notification overstated the defects of the technology and was an attempt by Franchiser to avoid its obligations under the contract.

Disagreements about mitigation may be hidden within the frameworks of the plaintiff’s and the defendant’s damages studies.

Example: Defendant Board Maker has breached an agreement to supply circuit boards. Plaintiff Computer Maker’s damages study is based on the loss of profits on the computers to be made from the circuit boards. Board Maker’s damages study is based on the difference between the contract price for the boards and the market price at the time of the breach.

Comment: There is an implicit disagreement about Computer Maker’s duty to mitigate by locating alternative sources for the boards not supplied by the defendant. The Uniform Commercial Code spells out the principles for resolving these legal issues under the contracts it governs.68

D. Are the Parties Disputing Damages That May Exceed the Cost of Avoidance?

An important consideration in capping damages may be the costs of steps that the plaintiff could have taken that would have eliminated damages. This argument is closely related to mitigation, but has an important difference: The defendant may argue that the plaintiff’s failure to undertake a costly step that would have avoided losses was reasonable, but that the failure to take that step shows that the plaintiff knew that damages were much smaller than its later damages claim.

Example: Insurance Company suffered a business interruption because a fire made its offices unusable for a period of time. Insurance Company’s damages claim for $10 million includes not only the lost business until the offices were usable but also damages for permanent loss of business from customers who found other sources during the period the

68. See, e.g., Aircraft Guaranty Corp. v. Strato-Lift, Inc., 991 F. Supp. 735, 738–39 (E.D. Pa. 1998) (Mem.) (finding that according to the Uniform Commercial Code, plaintiff-buyer had a duty to mitigate if the duty was reasonable in light of all the facts and circumstances, but that failure to mitigate does not preclude recovery); S.J. Groves & Sons Co. v. Warner Co., 576 F.2d 524 (3d Cir. 1978) (holding that the duty to mitigate is a tool to lessen plaintiff’s recovery and is a question of fact); Thomas Creek Lumber & Log Co. v. United States, 36 Fed. Cl. 220 (1996) (finding that under federal common law the U.S. government had a duty to mitigate in breach-of-contract cases).
offices were unusable. Defendant argues that the plaintiff’s failure to relocate to temporary quarters shows that their losses were less than the $350,000 cost of that relocation.

Comment: Defendant’s argument has the unstated premise that Insurance Company could have carried on its business and avoided any of its later losses by relocating. Insurance Company will likely argue that a decision not to relocate was commercially appropriate because relocation would not have avoided much of the lost business.

E. Are the Parties Disputing a Liquidated Damages Clause?

In addition to legally imposed limitations on damages, the parties themselves may have agreed to impose limits on damages should a dispute arise. Such clauses are common in many types of agreements. Once litigation has begun, the parties may dispute whether these provisions are legally enforceable. The law may limit enforcement of liquidated damages provisions to those that bear a reasonable relation to the actual damages. In particular, the defendant may attack the amount of liquidated damages as an unenforceable penalty. The parties may disagree on whether the harmful event falls within the class intended by the contract provision.

Changes in economic conditions may be an important source of disagreement about the reasonableness of a liquidated damages provision. One party may seek to overturn a liquidated damages provision on the grounds that new conditions make it unreasonable.

Example: Scrap Iron Supplier breaches supply agreement and pays only the specified liquidated damages. Buyer seeks to set aside the liquidated damages provision because the price of scrap iron has risen, and the liquidated damages are a small fraction of actual damages under the expectation principle.

Comment: There may be conflict between the date for judging the reasonableness of a liquidated damages provision and the date for measuring expectation damages, as in this example. Generally, the date for evaluating the reasonableness of liquidated damages is the date the contract is made. In contrast, the date for measuring expectation damages is the date of the breach. The conflict may be resolved by the substantive law of the jurisdiction. Enforcement of the liquidated damages provision in this example will induce inefficient breach.