

## Avoiding breach of contract: Deal with an honorable person

This column winds up my four-part series on commercial contracts. We've previously discussed the formation, interpretation and enforcement of contracts. Now we turn to the last component of the contract process: recovery of damages for breach.

As every business owner knows, commerce is based on contracts. Often the success of a business can depend on the other guy performing as agreed. Fortunately most do as they say, but there will always be some who won't. In those cases, a business owner must call upon the law for relief.

Under contract law, a defaulted party is entitled to be "made whole." That concept has a broad meaning, but simply stated, the person defaulted is entitled to recover damages that will restore him or her to the same position as if the contract were fully performed.

There are a variety of damages that come into play here, and each has its own definition and rules of application. Some are readily recoverable, and others only in specific situations.

Let's look at the different damages and when they're applied.

### General damages

General damages — economic losses that directly result from a person's failure to perform — are the most common and recoverable. Also called compensatory damages, they compensate people who've been defaulted for the loss of their bargain.

Illustration: Let's assume Acme Manufacturing has to replace some production equipment at its manufacturing plant. Acme enters into a contract with ABC Equipment Company to buy replacement equipment. As part of the deal, ABC agrees to ship the equipment by a certain date. But ABC fails to carry through, forcing Acme to buy other equipment at a higher price. In this case, Acme would have a right to recover the difference in the purchase price.



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### Incidental damages

Closely related to general damages, these are costs that are incidental to someone's failure to perform. Costs incurred for additional shipping, inspection and testing, professional services, and cure and remedy are some examples. Assume ABC provided replacement equipment that was incompatible with Acme's other production equipment. To resolve the compatibility issue, Acme hires an engineering firm to diagnose and fix the problem. In this case, Acme would have a right to recover the cost of the engineering services.

### Special damages

Special damages are only recoverable in certain situations, such as loss of profit. To recover, a person must prove "special circumstances" and resulting specific economic loss. More importantly, the person must prove the defaulting party was aware of the special circumstances and consequences at the time the contract was made. Using the same illustration, assume Acme told ABC the shipment date was critical to the continued operation of its production line. In this case, ABC was aware of Acme's special circumstances and the potential consequences. Assuming Acme can

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prove its loss of profits, Acme would have a right to file a claim.

## **Interest damages**

Interest damages are recoverable only in cases involving money obligations. Under Kentucky law, a contracting party is entitled to recover 8 percent interest on liquidated debt, defined as a specific monetary obligation owed under a contract. The obligation to pay a specific purchase price would qualify. As a general rule, interest damages cannot be recovered on a party's losses or costs.

## **Litigation damages**

Litigation damages include court costs and attorneys' fees. Kentucky law says a contract holder is entitled to recover the filing fee and original cost of depositions taken during litigation, but not attorneys' fees unless the contract specifically covers them.

## **Punitive damages**

Punitive damages are generally not recoverable in breach-of-contract cases. Unrelated to economic loss, they are damages used to punish someone for willful and outrageous conduct. Generally, these damages are only recoverable when a breach-of-contract claim is combined with other claims of personal injury or harm, such as wrongful-death cases involving defective cars that roll over or blow up.

All these damages are designed to reimburse someone for the bargain lost under a defaulted contract. Unfortunately, they're of little value if the person defaulting is broke. When all is said and done, your best protection against a defaulted contract lies within you. Make sure the person you contract with is both honorable and solvent.

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