

## Key Concept 9: Understand the differences between compensatory and punitive damages<sup>1</sup>

### A. Torts

#### 1. Compensatory and Punitive Damages

Tort law involves civil liability between private parties. A plaintiff who wins a tort suit usually recovers the actual damages or compensatory damages that she suffered because of the tort. Depending on the facts of the case, these damages may be for direct and immediate harms, such as physical injuries, medical expenses, and lost pay and benefits, or for harms as intangible as loss of privacy, injury to reputation, and emotional distress.

In cases where the defendant's behavior is particularly bad, injured victims may also be able to recover punitive damages. Punitive damages are not intended to compensate tort victims for their losses. Instead, they are designed to punish flagrant wrongdoers and to deter them and others from engaging in similar conduct in the future. Theoretically, therefore, punitive damages are reserved for the worst kinds of wrongdoing. Punitive damages have always been controversial, but they have grown more so in recent years due to the size of some punitive damage awards and the perception that juries are awarding them in situations where they are not justified.

#### 2. Negligence Defenses

The common law traditionally recognized two defenses to negligence: contributory negligence and assumption of risk. In many states, however, one or both of these traditional defenses has been superseded by new defenses called comparative negligence and comparative fault.

Contributory negligence is the plaintiff's failure to exercise reasonable care for her own safety. Where it still applies, contributory negligence is a complete defense for the defendant if it is a substantial factor in producing the plaintiff's injury. Traditionally, even a minor failure to exercise reasonable care for one's own safety, only a slight departure from the standard of reasonable self-protectiveness, gave the defendant a complete contributory negligence defense. For example, the rule may prevent slightly negligent plaintiffs from recovering any compensation for their losses, while only marginally more careful plaintiffs get a full recovery.

In response to [complaints of its harsh impact on most plaintiffs], most of the states have adopted comparative negligence systems either by statute or by judicial decision. The details of these systems vary, but the principle underlying them is essentially the same: Courts seek to determine the relative negligence of the parties and award damages in proportion to the degree of negligence determined. The formula is:

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<sup>1</sup> Excerpts taken from Jane P. Mallor, et al., Business Law and the Regulatory Environment (11<sup>th</sup> ed. 2001).

Plaintiff's recovery = Defendant's percentage share of the negligence causing the injury multiplied by Plaintiff's provable damages.

Assumption of the risk is the plaintiff's *voluntary* consent to a *known* danger. Voluntariness basically means that the plaintiff accepted the risk of her own free will; knowledge means the nature and extent of the risk was subjectively present to the plaintiff's consciousness. Often, the plaintiff's knowledge and voluntariness are implied from the facts of the case. A plaintiff can also expressly assume the risk of injury by entering a contract purporting to relieve the defendant of a duty of care that he would otherwise owe to the plaintiff.

What happens to assumption of the risk in comparative negligence states? Some of these states have eliminated assumption of the risk as a separate defense. Assumption of the risk is often incorporated within the state's comparative negligence scheme. In such states, comparative negligence basically becomes comparative fault. In a comparative fault state, therefore, the fact finder determines the plaintiff's and the defendant's relative shares of the fault, including assumption of the risk, causing the plaintiff's injury.

## B. Breach of Contract

Contract law seeks to encourage people to rely on the promises made to them by others. Contract remedies focus on the economic loss caused by breach of contract, not the moral obligation to perform the promise. The objective of granting a remedy in a case of breach of contract is simply to compensate the injured party.

The usual remedy is an award of money damages that will compensate the injured party for his losses. This is called a legal remedy or remedy at law, because the imposition of money damages in our legal system originated in courts of law. A person who has been injured by a breach of contract is entitled to recover compensatory damages.

### 1. Protected Interests

In calculating the compensatory remedy, a court will attempt to protect the expectation interest of the injured party by giving him the "benefit of his bargain" (placing him in the position he would have been in *had the contract been performed as promised*). To do this, the court must compensate the injured person for the provable gains that he has been prevented from realizing by the breach of contract.

A promisee's reliance interest is his interest in being compensated for losses that he has suffered by changing his position in reliance on the other party's promise. In some cases, such as when a promisee is unable to prove his expectation interest with reasonable certainty, the promisee may seek a remedy to compensate for the loss suffered as a result of relying on the promisor's promise rather than for the expectation of profit.

A restitution interest is a party's interest in recovering the amount by which he has enriched or benefited the other. Both the reliance and restitution interests involve promisees who have changed their position. The difference between the two is that the reliance interest involves a loss to the promisee that does not benefit the promisor, whereas the restitution interest involves a loss to the promisee that does constitute an unjust enrichment to the promisor. A remedy based on restitution enables a party who has performed or partially performed her contract and has benefited the other party to obtain compensation for the value of the benefits that she has conferred.

## 2. Compensatory Damages

Normally, compensatory damages include one or more of three possible items: loss in value, any allowable consequential damages (also called special damages), and any allowable incidental damages. The starting point in calculating compensatory damages is to determine the loss in value of the performance that the plaintiff had the right to expect. The calculation of the loss in value experienced by an injured party differs according to the sort of contract involved and the circumstances of the breach. In contracts involving nonperformance of the sale of real estate, for example, courts normally measure loss in value by the difference between the contract price and the market price of the property. Where a seller has failed to perform a contract for the sale of goods, courts may measure loss in value by the difference between the contract price and the price that the buyer had to pay to procure substitute goods.

Consequential damages are damages that do not flow directly and immediately from an act but rather flow from the results of the act; damages that are indirect consequences of a breach of contract. For example, Apex Trucking Company buys a computer system from ABC Computers. The system fails to operate properly, and Apex is forced to pay its employees to perform the tasks manually, spending \$10,000 in overtime pay. In this situation, Apex might seek to recover the \$10,000 in overtime pay in addition to the loss of value that it has experienced. Lost profits flowing from a breach of contract can be recovered as consequential damages if they are foreseeable and can be proven with reasonable certainty.

Incidental damages compensate for reasonable costs that the injured party incurs after the breach in an effort to avoid further loss. For example, if Smith Construction Company breaches an employment contract with Brice, Brice could recover as incidental damages those reasonable expenses he must incur in an attempting to procure substitute employment, such as long-distance telephone tolls or the cost of printing new resumes.

## 3. Limitations on Recovery

An injured party's ability to recover damages in a contract action is limited by three principles:

(1) A party can recover damages only for those losses that he can prove with reasonable certainty. Losses that are purely speculative are not recoverable.

(2) A breaching party is responsible for paying only those losses that were foreseeable to him at the time of contracting. A loss is foreseeable if it would ordinarily be expected to result from a breach or if the breaching party had reason to know of particular circumstances that would make his loss likely.

(3) Plaintiffs injured by a breach of contract have the duty to mitigate (avoid or minimize) damages. A party cannot recover for losses that he could have avoided without undue risk, burden, or humiliation.

#### 4. Punitive Damages

Punitive damages are damages awarded in addition to the compensatory remedy that are designed to punish a defendant for particularly reprehensible behavior and to deter the defendant and others from committing similar behavior in the future. The traditional rule is that punitive damages are not recoverable in contracts cases unless a specific statutory provision (such as some consumer protection statutes) allows them or the defendant has committed *fraud* or some other independent tort. A few states will permit the use of punitive damages in contracts cases in which the defendant's conduct, though not technically a tort, was malicious, oppressive, or tortuous in nature.

