Welcome to this podcast on Foreseeability brought to you by CALI. I am Professor Scott J. Burnham.

The topic of this podcast is when consequential damages can be recovered for breach of contract because they are foreseeable.

The principle of foreseeability is of great practical importance in contracts. Historically, it goes back to the case of *Hadley v. Baxendale*,an English case decided in 1854. The facts of that case are a good example of foreseeability and in fact a very modern example as we shall see. In that case there was a mill, and a mill shaft that was necessary to the operation broke. The mill contracted with a carrier to ship the shaft by barge for repair. The carrier promised that the shaft would be absolutely positively delivered overnight. Well, it wasn't, and there was a few days delay in the return of the repaired mill shaft. So the mill sued for the lost profits – the money it would have made if it had an operating mill shaft. Apparently the trial court operated under the rule that the jury was allowed to award the damages that the jury felt was reasonable. But the appellate court thought that this encouraged juries to be reckless with contract damages, and they felt more guidance was necessary. Some historians speculate that the case was decided at the time of the industrial revolution when it was necessary to encourage the development of commerce and if there had been excessive damages this would have discouraged growing industry.

So for whatever reason, the court came up with a rule that limits the damages available to the non-breaching party. There are two limitations. The first rule of *Hadley* is that the injured party can always recover the damages that arise naturally from the breach – we call these direct damages. I tend to think of these as the damages that always result from a breach – the loss of the thing itself that was promised. For example, in *Hadley* it would be the rental value of a mill shaft for a few days – that's what the plaintiff didn't have because of the breach. The second rule is that the injured party can recover for the losses that a reasonable person in the shoes of the breaching party would have known at the time they made the contract would likely result from a breach (meaning the losses were foreseeable). We call this type of additional losses consequential damages. They don’t always result from a breach, and even if they do, a breaching party is not responsible for them if they don’t know the loss was likely to occur because it was not foreseeable. So in *Hadley*, the question was, would the carrier know that the mill would not be able to operate if the carrier didn’t get the mill shaft to the repair shop in time? That is: Was the non-operation foreseeable?

The answer, according to the court, is that the shipper might not know that the mill wouldn’t be able to operate because a) the mill might have a spare mill shaft lying around, and b) there might be something else wrong with the mill other than the mill shaft and a shipper wouldn’t know that just because it doesn't have a mill shaft the mill wouldn’t be able to operate.

So in general, how does a party know what losses might result from the breach? One answer is they have actual knowledge – they were told by the other party. The other answer is that they have imputed knowledge. The test is objective, so the question is what would we expect a reasonable person to know from the facts and circumstances.

For example, I go to a tire store and buy tires for my car. One of the tires blows out and damages the car, as well as some property that the car hits. As you may know from your study of warranty law, I have a claim against the seller for breach of the implied warranty of merchantability. What are the direct damages? Well, when a tire fails, it always results in damage to or the loss of the tire. That is what we would call the direct damages and those damages are always recoverable if caused by the breach. When the tire failed, that caused damage to the car and to other personal property. That does not always happen, and it was set in motion by the breach, so we call those damages consequential damages. So now we have to ask the *Hadley* foreseeability question – Would a reasonable person in the shoes of the tire store have known at the time they sold me the tires that if the tires failed, they would likely cause damage to personal property? I think the answer is clearly yes, the losses are foreseeable, so the seller would be responsible for that loss.

By the way, this may have just rung a bell with something you learned in Civil Procedure. In procedure, the direct damages are called general damages. If I sue the tire store, claiming that my tire blew out, I can recover those damages without detailing them. The consequential damages are called special damages in pleading. I can only recover them if I plead them specially – put the defendant on notice that they occurred. This is consistent with *Hadley* because the defendant knows that general damages always occur, so I shouldn’t have to give them notice of those, but they don’t necessarily know they will be liable for special damages.

One of the practical effects of the *Hadley* rules is that once a party is aware of what the foreseeable damages are, then it is in a position to bargain for whether it will accept liability for them or not. For example, I go to a parcel delivery store and they promise they will absolutely positively get my package to Minneapolis overnight. It doesn’t get there on time. I tell them I lost $5,000 because of that. They say, “Sorry, according to *Hadley*, we didn’t know that, so we are not responsible.” They are of course right. I have learned my lesson, so next time I tell them, “If it doesn’t get there overnight, I will lose $5,000.” Once they know that, they are liable for it. Well, they’re not stupid, so now they have learned their lesson. The next time I go in and tell them I will lose $5,000 if the package does not get there overnight, they say, “Sorry, we refuse to take it unless you agree that we will not be liable for the consequential damages. We will still be liable for the mailing costs, but we won't be responsible for any additional damages unless you buy insurance.” Knowing what the damages might be, they have shifted the risk of loss back to me. If you look at the terms and conditions on the label of a parcel delivery service, you will find they say exactly something like that – so *Hadley* lives!

One more twist to this. Back to our tire store. Knowing the loss that might result if the tire fails, the tire store puts in its contract with me, “We are not responsible for consequential damages.” Can they do that? Tires are goods, so this transaction is governed by Article 2 of the UCC. The default rule in § 2-714(3) of the Code is that a buyer but not a seller may recover consequential damages. But the rule of § 2-719(3) allows the seller to disclaim liability for consequential damages, with one exception. In the case of consumer goods, it is presumptively unconscionable to disclaim liability for personal injury. So in my example, the disclaimer would probably be effective to disclaim contract liability for the property damage, but if I was injured because of the defective tire, then I would still have a claim.

Another strength of the *Hadley* rule is that it enables parties to plan ahead. For example, a client walks into your office and says, “I am thinking of breaking this contract.” Are you going to say, “Get out of my office, you dirty contract breaker!”? No, you are going to sit down and say, keeping in mind the rules of *Hadley*, let’s see what losses are likely to result from your breach. They can use that in making a determination whether to breach or not. And of course the same thing happens when the non-breaching party asks you to determine what it is likely to recover in a breach of contract claim. Because of the rules regarding foreseeable damages, together with the rules regarding reasonable certainty, the parties are in a position to make a reasonable estimate of damages and plan accordingly.

This concludes the podcast on Foreseeability. At this point, you should be able to apply the *Hadley* rules to determine whether the party in breach is liable for consequential damages. You should also be able to explain how a party can avoid that liability.

I hope you’ve enjoyed this podcast on Foreseeability.

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