

Problem 7.1

Expectation damages places the promisee in the position he/she would have been in had the contract been performed. Expectation damages make the promisee indifferent between performance of the original contract and breach with an accompanying damage payment. In this case, the buyer had planned to earn a \$900 profit (\$11,000-\$10,000-\$100). He has already paid \$10,000 to D and \$100 in docking fees. Thus, expectation damages = \$900 + \$10,100 = \$11,000.

<u>Need:</u>	<u>Have:</u>
Pay \$10,000 to D	Paid \$10,000 to D
Pay \$100 docking fee	Paid \$100 docking fee
Sell for \$11,000	

$$900 = X - 10,100$$
$$X_{\text{exp}} = \$11,000$$

Opportunity cost damages place the promisee in the position he/she would have been in had the next best contract been performed. Opportunity cost damages make the promisee indifferent between performance of the next best contract and breach with an accompanying damage payment. In this case, the buyer had planned to earn a \$400 profit (\$11,000-\$10,500-\$100). He has already paid \$10,000 to D and \$100 in docking fees. Thus, opportunity cost damages = \$400 + \$10,100 = \$10,500.

<u>Need:</u>	<u>Have:</u>
Pay \$10,500	Paid \$10,000 to D
Pay \$100 docking fee	Paid \$100 docking fee
Sell for \$11,000	

$$400 = X - 10,100$$
$$X_{\text{opp cost}} = \$10,500$$

Reliance damages place the promisee in the position he/she would have been in had there been no contract. Reliance damages make the promisee indifferent between not entering into any contract and breach with an accompanying damage payment. In this case, the buyer has already paid \$10,000 to D and \$100 in docking fees. Thus, reliance damages = \$10,000 + \$100 = \$10,100.

<u>Need:</u>	<u>Have:</u>
Pay nothing	Paid \$10,000 to D
	Paid \$100 docking fee

$$0 = X - 10,100$$
$$X_{\text{rel}} = \$10,100$$

Golf problem:

1. Reliance damages place Kayla in the position that she would have been in had she never entered into any contract for golf lessons. If she hadn't entered into the contract with Jeff, she would not have spent the \$2,000 for clubs and the \$5,000 for travel. Thus, her reliance was \$7,000. Reliance damages would be \$7,000. (Remember, we assume that the clubs and travel provide her with NO utility if she can't take lessons.)

2. Expectation damages place Kayla in the position that she would have been in had the original (first-choice) contract been performed. Kayla wanted to spend \$2,000 for clubs, \$5,000 for travel, and \$50,000 for lessons. Instead, she has spent \$2,000 for clubs, \$5,000 for travel, and \$60,000 for lessons (her next best alternative). Thus, expectation damages would be \$10,000 (\$67,000-\$57,000).

3. Reliance is optimal if the expected gains to Kayla from the reliance exceed the expected costs from relying in vain.

If $(\text{prob. of performance}) \times (\text{increase in value from reliance}) >$
 $(\text{prob. of breach}) \times (\text{cost of reliance})$

Expected gains from reliance = $0.8 \times (0.1 \times \$1,000,000) = \$80,000$.

Expected cost of relying in vain = $0.2 \times \$7,000 = \$1,400$.

$\$80,000 > \$1,400$ so reliance was optimal.

4. Breach is optimal if the expected gains to Jeff exceed any damages that he would have to pay Kayla. Jeff gains \$30,000 from breaching the contract with Kayla (\$80,000-\$50,000). Expectation damages are the greatest of the three damages, so if the gains exceed expectation damages, then the breach is efficient. Expectation damages are \$10,000. $\$30,000 > \$10,000$ so the breach was optimal.