The "Losing Contract" Limitation on Reliance Damages in California Breach of Contract Cases - *Agam v. Gavra*.

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In *Agam V. Gavra*, 2015 WL 1843009, the Sixth District Court of Appeals in California recognized a "losing contract" limitation on reliance damages in California breach of contract cases, and laid out the respective burdens of the parties in such cases. For its discussion of reliance damages alone, this case will be useful to any California attorney litigating contract cases. And, its recognition of a "losing contract" limitation on reliance damages provides an opening to breaching parties to limit exposure for their own breaches.

The case involved a partnership agreement for the purchase and development of land in Los Altos Hills, California. The deal apparently spoiled with the collapse of the housing market and the Great Recession, leading to litigation. The losing side on breach claims appealed, contending, in part, the trial court misallocated the burden of proof on breach of contract reliance damages.

In its opinion, the Sixth District first noted the traditional definition of reliance damages in California:

> One proper "measure of damages for breach of contract is the amount expended [by the nonbreaching party] on the faith of the contract." (Mendoyoma, Inc. v. County of Mendocino (1970) 8 Cal.App.3d 873, 879 (Mendoyoma); 1 Witkin, Summary of Cal. Law (10th ed. 2005) Contracts, § 883, p. 970 ["[One] measure of contract damages is the amount of the plaintiff's expenditures, together with the reasonable value of his or her own services, in preparation and performance in reliance on the contract."].) As our Supreme Court explained in Buxbom v. Smith (1944) 23 Cal.2d 535, 541, " '[w]here, without fault on his part, one party to a contract who is willing to perform it is prevented from doing so by the other party, the primary measure of damages' " includes " 'his reasonable outlay or expenditure toward performance.' "That the nonbreaching party's damages include his or her "outlay incurred in making preparations for the contract" has been the law in California for over a century. (Cederberg v. Robison (1893) 100 Cal. 93, 99 (Cederberg); see also United States v. Behan (1884) 110 U.S. 338, 345–346 (Behan) [nonbreaching party's damages include "actual outlay and expenditure"].)

The court described the well-recognized burdens on the parties in the context of reliance damages. The burden is initially on the non-breaching plaintiff to establish the amount which he was induced to expend in reliance on the breached contract. The burden then shifts to the breaching defendant to show the plaintiff's expenses were unnecessary, such that his recovery of reliance damages should be reduced. Standard breach of contract stuff!

But, the Court then discussed a second limitation on reliance damages – the "losing contract" limitation – which allows the defendant to reduce or eliminate plaintiff's reliance damages with proof the plaintiff would have suffered a loss even if the defendant had fully performed. The court noted no California court appears to have addressed the "losing contract" limitation upon awards of reliance damages. Citing a variety of out-of-state cases, the court discussed the "losing contract" limitation as follows:

> Courts also have recognized a second limitation on reliance damages awards (aside from proof of unnecessary expenditures)—proof that the plaintiff would have suffered a loss even if the defendant had fully performed. "[I]n such a case the plaintiff should not be permitted to escape the consequences of a bad bargain by falling back on his reliance interest." (Dialist Co. v. Pulford (Md.Ct.Spec.App.1979) 399 A.2d 1374, 1380.) Put differently, the plaintiff should not be put " 'in a better position than he would have occupied had the contract been fully performed.' " (Bausch & Lomb Inc. v. Bressler (2nd Cir.1992) 977 F.2d 720, 729 (Bausch & Lomb).) Thus, much like courts allow the breaching party to prove the nonbreaching party's expenditures were unnecessary, courts allow the breaching party "to reduce [the nonbreaching party's recovery] by as much as he can show that the [nonbreaching party] would have lost, if the contract had been performed." (L. Albert & Son v. Armstrong Rubber Co. (2nd Cir.1949) 178 F.2d 182, 189 (L.Albert); (Holt v. United Sec. Life Ins. & Trust Co. (1909) 76 N.J.L. 585, 597 (Holt) ["if he who, by repudiation, has prevented performance, asserts that the other party would not even have regained his outlay, the wrong-doer ought at least to be put upon his proof"]; Westfed Holdings, Inc. v. United States (Fed.Cl.2002) 52 Fed.Cl. 135, 155 (Westfed Holdings) rev'd in part on other grounds, 407 F.3d 1352 (Fed.Cir.2005) [plaintiff "must show that the expenses submitted as reliance damages were incurred in reliance on the contract ... while defendant may prove, in diminution of the amount of losses proved by plaintiff, any losses that plaintiff would have incurred in the event of full performance of the contract"]; Bausch & Lomb, supra, at p. 729 ["a reliance recovery will be offset by the amount of 'any loss that the party in breach can prove with reasonable certainty the injured party would have suffered had the contract been fully performed.' "].)

The court's holding laid out the respective burdens of the parties in the context of reliance damages to include the "losing contract" limitation:

> Accordingly, we hold that, in the context of reliance damages, the plaintiff bears the burden to establish the amount he or she expended in reliance on the contract. The burden then shifts to the defendant to show (1) the amount of plaintiff's expenses that were unnecessary and/or (2) how much the plaintiff would have lost had the defendant fully performed (i.e., absent the breach). The plaintiff's recovery must be reduced by those amounts.

Agam v. Gavra is significant because it opens up a new avenue for defendants, in breach of contract cases where reliance damages are sought, to argue, if the facts so warrant, that plaintiff should not be able to recover some or all his claimed reliance damages because he would have done worse if the contract had been fully performed. As the court stated, under such circumstances, the plaintiff “should not be permitted to escape the consequences of a bad bargain by falling back on his reliance interest.” So, at trial, plaintiff proves he spent $1M in reliance on the now-breached contract and wants judgment in that amount for breach. To negate those claimed reliance damages, defendant can then attempt to prove that if he had not breached, plaintiff would have lost more than $1M on the contract and plaintiff should not be put in a better position upon breach than he would have been in the absence of breach. In effect, defendant puts on a “this is what would have happened to plaintiff if I hadn’t breached - I did him a favor" case! Interesting.

Agam v. Gavra – a must read for any California attorney litigating contract cases.