Reliance Damages in Automotive Supplier Disputes

David A. Sebastian

This article simplifies a factual scenario between automotive suppliers that was recently tried before a jury in federal court. In this factual scenario, an automotive supplier allegedly incurred substantial expense to make parts pursuant to a contract that was prematurely terminated by the buyer of the parts.

The expenses incurred are commonplace to anyone in the automotive business: numerous meetings with countless professionals taking place across the country on a moment's notice at the behest of the OEM; research and development to make a part that undergoes numerous revisions through various phases of production; travel costs; raw material costs; and tooling costs.

We analyze the ability of a Plaintiff to recover reliance damages for the costs incurred in preparing to perform a contract that is prematurely terminated by the buyer of the part.

FACTS

Tier One Corporation ("Tier One") had entered into an agreement with OEM Corporation ("OEM") to act as a supplier for suspensions to be used on its truck platforms. Tier Two Corporation ("Tier Two") was a supplier to Tier One Corporation for various components on the suspensions.

There were a number of agreements between Tier One and Tier Two Corporation. In one agreement, Tier Two agreed to sell and Tier One agreed to buy, all of the various components for the suspensions for a period of three years and further agreed that:

> "Tier Two is committed to support the continued growth and leadership in Tier One's truck and suspension business. Tier Two commits to deploy resources to create unique competitive advantages exclusively for Tier One in this business in exchange for Tier One's commitment to actively pursue a dominant market share position with Tier Two's products specific to this business."

In subsequent agreements between Tier One and Tier Two Corporation, both parties agreed that Tier One was required to issue a purchase order to Tier Two before Tier Two Corporation would perform any work and before Tier One was required to pay for any work performed. Thereafter, Tier One Corporation issued numerous purchase orders to Tier Two Corporation for various parts and components.

OEM canceled the project. Tier One Corporation immediately informed Tier Two Corporation to stop all work on the project.

Tier Two Corporation filed suit against Tier One Corporation alleging that it had incurred substantial costs in reliance on Tier One's commitment to "deploy resources to create unique competitive advantages exclusively for Tier One Corporation" and that Tier One Corporation failed to "actively pursue a dominant market share position with Tier Two's products." The Agreement is silent as to the effect of zero market for the product given OEM's decision to terminate its supply agreement with Tier One Corporation.

In defense of the claim, Tier One Corporation argued that its liability is limited to purchase orders issued to Tier Two Corporation, only. Tier Two argued for every penny that it had ever spent associated with the support of the project.

RELIANCE DAMAGES

As set forth above, there were a number of agreements between Tier One and Tier Two allowing for each party to argue for the enforcement of terms most favorable to its position. "[W]here there are several agreements relating to the same subject matter the intention of the parties must be gleaned from all the agreements." *Culver v Castro*, 126 Mich. App. 824, 826 (1983); *accord West Madison Inv. Co. v Fileccia*, 58 Mich. App. 100, 106 (Mich. Ct. App. 1975)("[I]n order to determine the intention of the parties, separate instruments executed at about the same time, in relation to the same matter and between the same parties and made as elements of one transaction may be examined together and construed as one instrument.").

Tier Two Corporation agreed that it would not commence any work until Tier One Corporation issued a purchase order, and that Tier One Corporation would not be required to pay for any work that was performed in the event that a purchase

order was not issued. In jurisdictions other than Michigan, courts have held plaintiffs assume the risk that their costs will not reimbursed if they incur expenses outside of the contract. *Nat'l Controls Corp.*, 833 F.2d at 499-500; *Gershman v IBM*, 619 F. Supp. 1530, 1534 (E.D. Penn. 1985).

However, in Michigan, Tier Two Corporation is entitled to submit a reliance damages claim to the jury based on the reasonable expenses incurred attempting to perform the contract. *Earl Dubey & Sons, Inc. v Macomb Concrete Corp., 81 Mich. App. 662, 680 (1978).* In order to recover reliance damages, "a plaintiff must prove that its expenditures were made reasonably and in reliance upon the contract." *Market Development Corp. v Flame-Glo, Ltd*, 1990 U.S. Dist. LEXIS 10275, *32 (E.D. Penn. 1990); *Earl Dubey & Sons, Inc. v Macomb Concrete Corp.*, 81 Mich. App. 662, 680 (1978)(noting that "the measure of damages is the actual expenditures and value of services *reasonably* spent in a bona fide attempt to perform the contract or reasonably expended upon the faith of the contract.")(emphasis added). Furthermore, in order to be recoverable as reliance damages, plaintiff's loss must have been foreseeable at the time of contract formation. *See Old Stone Corp. v United States*, 450 F.3d 1360, *37 (Fed. Cir. 2006); *Device Trading, Ltd. v Viking Corp*, 105 Mich. App. 517, 526 (1981); *Cavacas v Zack*, 43 Mich. App. 222, 227 (1972).

Reliance damages may not be recovered where the plaintiff's expenditures were unreasonable: "[P]laintiff may choose to recover expenditures made in reliance on a contract or commitment when there is insufficient proof of lost profits. This rule presupposes, however that the plaintiff presented proof that its expenditures were made *reasonably." Nat'l Controls Corp. v Nat'l Semiconductor Corp.*, 833 F.2d 491, 499 (3rd Cir. 1987)(emphasis added); *see also Earl Dubey & Sons, Inc. v Macomb Concrete Corp.*, 81 Mich. App. at 680.

Furthermore, in order to be recoverable as reliance damages, the expenditures must have been made in actual reliance on the contract, *i.e.*, the expenses must have been incurred after the contract was formed and before the plaintiff learned of the breach. *See Brown Bros Equip. Co. v State*, 51 Mich. App. 448, 451 (1974); *Market Development Corp. v Flame-Glo, Ltd*, 1990 U.S. Dist. LEXIS 10275, *33 (E.D. Penn. 1990)(expenses incurred before the contract is formed are not properly recoverable as reliance damages). Tier Two Corporation may argue that an agreement and understanding was formed early in the process, from which there will undoubtedly be writings (if not formal agreements), while Tier One Corporation will seek to rely upon the boilerplate provisions in its purchase orders.

Damages measured by reliance may be denied if the damages were not foreseeable as a probable result of the breach at the time the contract was made. *Lord's & Lady's Enters. v John Paul Mitchell* Sys., 46 Mass. App. Ct. 262, 269 (Mass. Ct. App. 1999)(quoting Farnsworth, Contracts § 12.16, at 278 (2d ed. 1998)); *Old Stone Corp.*, 450 F.3d 1360 at *37. Tier One Corporation will likely have difficulty arguing that Tier Two Corporation's costs and expenses were not foreseeable, especially given that the costs and expenses incurred were done so to satisfy the demands of Tier One Corporation and the OEM.

CONCLUSION

It is commonplace for suppliers to incur substantial expenses in expectation of a significant part production run. In some cases, the buyer of the parts will pay in advance for the tools needed to make the parts. In many other cases, the buyer will pay more per part over the life of the contract to cover the costs incurred by the seller in making the part and will not pay up-front, "start up" costs. As the tooling costs are often an integral part of the economic negotiations, it is difficult for the buyer of the parts to argue that the tooling costs were not foreseeable.

As suppliers embark on a new relationship, there are often numerous writings between the parties that creative counsel can use to her advantage to recoup the costs incurred to supply the parts in question. Counsel should not limit her damage request to unpaid invoices but should instead determine if additional claims can be made for tooling costs, development costs, travel costs, meeting time, and all other costs incurred to support the production of the part.