THE PERFORMANCE INTEREST IN CONTRACT DAMAGES

Introduction

The *Reliance Interest* article by Fuller and Perdue, published in 1936,[1] lay half dormant for rather a long time. It surged into great prominence many years later,[2] probably in the sixties, and has since enjoyed a dazzling academic success, being described as the most significant article on contract law[3] and the most famous contract article ever written.[4] The article introduced new, albeit inappropriate, terminology which has become the standard terminology in American legal parlance and is now rapidly spreading over the Atlantic. By contrast, its effect on substantive law has been remarkably meagre.[5] The basic ideology, advocated in the article with regard to the performance interest (in the article's terms, "expectation interest"), has been rejected. Indeed, the protection granted to this interest, since the publication of the article, has been greatly expanded.[6] The irony is that while rejecting the article's basic approach, courts and scholars increasingly employ the terminology which it introduced.

The *Reliance Interest* article occupies the middle ground, both in time and approach, between Holmes's "right to break a contract" theory[7] and Gilmore's *Death of Contract*. Holmes's theory appeared in his book *The Common Law* published in 1881. *The Reliance Interest* was published in 1936, some 50 years later. From there it took about 40 years to Gilmore's *Death of Contract* (1974). *The Reliance Interest* shares with Holmes the basic fascination with remedies and the emphasis upon damages.[8] Both reflect an attempt to view the contractual right through the looking glass of the damages awarded for its breach. They also share a similar flaw in almost completely disregarding the relevance of the remedy of specific performance for which damages are a mere substitute.

[1] Fuller and Perdue, "The Reliance Interest in Contract Damages" (1936) 46 Yale L.J. 52, 373 (hereafter "Fuller and Perdue").

[2] Macaulay, "The Reliance Interest and the World Outside the Law Schools' Doors" [1991] Wis.L.Rev. 247, relates that when he started teaching contracts in 1958 he discovered that he "had to teach something called "the expectation interest".

[3] Birmingham, "Notes on the Reliance Interest" (1985) 60 Wash.L.Rev. 217.

[4] Linzer, *A Contracts Anthology* (1989), at p. 421. See also Atiyah, *Essays on Contract* (1990), Essay 4 p. 75 speaking about Fuller's "great reliance article".

[5] See *infra*, text to n. 87 *et seq*.

[6] See *infra*, text after n. 94.

[7] Holmes, *The Common Law* (1881), pp. 300-301. For a criticism see Friedmann, "The Efficient Breach Fallacy" (1989) 18 J. Legal Stud. 1.

[8] The renewed interest in damages might presumably be attributed, at least in part, to the legal realists: Rakoff, "Fuller and Perdue's *The Reliance Interest* as a Work of Legal Scholarship" [1991] Wis.L.Rev. 203.

However, Fuller and Perdue deviated from Holmes right from the beginning of their article by questioning the very justification of the normal measure of contract damages. The authors try to shift the emphasis from the interest which is the core of contract law, namely, the interest in the performance of the contract, to losses suffered in reliance on the contract. It is hardly surprising that the idea of reliance losses, which superficially resembles the principles of damages obtaining in tort,[9] provided a stepping stone for Gilmore's "death of contract" theory, under which contract law is being reabsorbed into the law of tort.

The purpose of this paper is to point out the inappropriateness of the terminology used, the difficulties in the reliance approach and thus to offer an explanation for the fact that despite its immense reputation, *The Reliance Interest* failed to have a significant effect on substantive contract law.

The Performance Interest and its Protection

The essence of contract is performance. Contracts are made in order to be performed.[10] This is usually the one and only ground for their formation. Ordinarily, a person enters into a contract because he is interested in getting that which the other party has to offer and because he places a higher value on the other party's performance than on the cost and trouble he will incur to obtain it. This interest in getting the promised performance (hereafter the "performance interest") is the only pure contractual interest. The performance interest is protected by specific remedies, which aim at granting the innocent party the very performance promised to him, and by substitutional remedies. The specific remedies are:

> (1) Specific performance and injuction, originally equitable and, therefore, discretionary remedies.
> (2) The recovery of a debt, namely, a sum of money promised under the contract either as price of goods or other property, remuneration for labor or services, or simply as a return of a loan. Where one party has fully (or, more precisely, "substantially") preformed, he is entitled as a matter of right to recover the amount promised to him. This claim, which originated in the

[9] The idea that compensation for reliance losses represent the principle of tort damages was earlier. It appeared already in Gardner, "An Inquiry into the Principles of the Law of Contract" (1932) 46 Harv.L.Rev. 1 at pp. 22-23. See also Rakoff, *supra*, note 8 at p. 209. The difficulty with this analogy is examined *infra*, text to nn. 56 *et seq*.

[10] *Cehave NV v. Bremer Handelsgesellschaft mbH (The Hansa Nord)* [1976] Q.B. 44 at p. 71 (C.A.) ("contracts are made to be performed and not to be avoided . . ." *per* Roskill L.J.).

common law courts, may be termed common law specific performance.[11] The remedy is non-discretionary and the party who performed is entitled to it as a matter of right.[12] The position is similar in insurance contracts in which a sum of money is promised if a certain event occurs. Payment of the promised amount constitutes a specific and not a substituted performance.[13]

The substitutional remedies are:

(1) Compensating damages or "loss of the bargain" damages. It is also possible to term them "performance damages", since they are intended to put the plaintiff in as good a position as that in which he would have been, had the contract been performed.[14] These damages, which constitute the most important substitutional remedy, are currently described by the unfortunate term "expectation damages" introduced by Fuller and Perdue.

(2) Recovery of the "substitute", which relates to the situation in which the promisor can no longer perform but has obtained a substitute for the promised performance. Examples of such a "substitute" include insurance proceeds for a loss, and damages or price paid by a third party. The remedy is well known in German law.[15] It is sometimes granted in Anglo-American law, which utilizes various routes to this end. Thus, suppose that A has entrusted his goods to B (a bailee or a carrier). The goods are damaged or lost in circumstances that give rise to a claim by B against C (a tortfeasor or an insurer). B is accountable to A for whatever he recovers from C.[16] The problem becomes more complex where A has no legal proprietary right and his entitlement is based on a contract with B. In *Rayner v. Preston*[17] it was held that the purchaser had no right to the insurance proceeds to which the vendor was entitled in respect of damage caused to the sold property before the sale was completed. However, this rule has been changed by legislation.[18] In another context it was held that a vendor, who in breach of a contract for the sale of land sold it to a third party, held the proceeds on trust for the purchaser.[19] Recently, the right to recover the substitute has been greatly expanded in a contractual setting. The issue arose in a case in which B undertook to perform certain work for A. B hired C to do the job. It was claimed that C's performance was unsatisfactory, but under the terms of the contract between A and B, A had no cause of action against B, while B had a claim against C. It was held that B was accountable to A for the damages recoverable from C.[20]

(3) Recovery in restitution of profits made by the other party through the breach. This remedy partly overlaps the right to the substitute ((2) above), but the extent of its availability has been much debated.[21] The Court of Appeal has recently denied this possibility,[22] but recovery of profits may be allowed if the breach of the contract also constitutes a breach of fiduciary duty or where the plaintiff acquired an equitable interest in the property promised to him.[23]

The performance interest is also protected against third parties by

[11] Treitel, *Law of Contract* (9th ed., 1995), at pp. 912–913.

[12] This rule led to an extreme result in *White and Carter (Councils) Ltd v. McGregor* [1962] A.C. 413.

[13] It seems that English law regards the insured's claim under an indemnity policy as a claim for unliquidated damages. See Chitty, *Contracts* (27th ed., 1994), vol. 2, pp. 924–925; *Chandris v. Argo Insurance Co. Ltd* [1963] 2 Lloyd's Rep. 65 at p. 74. However, the claim is not for damage caused by the insurer's breach of contract. It is a claim for compensation payable by the insurer upon the occurrence of a loss for which the insurer is not otherwise responsible. The point was explained by Pearson J. in *Jabbour v. Custodian of Israeli Absentee Property* [1954] 1 W.L.R. 139 at pp. 143–144 by reference to the old form of pleading in assumpsit. He pointed out that the insurer is "in much the same position as a person who owes and has failed to pay a reasonable price for goods sold and delivered . . . The claim is for unliquidated damages, but the word "damages" is used in a somewhat unusual sense" (*ibid.*).

[14] The injured party may elect to claim damages based upon his reliance losses (provided that they do not exceed his performance interest): Treitel, *supra*, n. 11, at pp. 847–851; (1992) 108 L.Q.R. 226; Bridge, "Expectation Damages and Uncertain Future Losses" in *Good Faith and Fault in Contract Law* (Beatson and Friedmann eds., 1995) 427 at pp. 462–463. See also *Restatement 2d, Contracts*, comment *a* to §349.

[15] BGB, §821; see also Friedmann, "Restitution of Benefits Obtained through the Appropriation of Property or the Commission of a Wrong" (1980) 80 Col.L.Rev. 504 at pp. 517–518.

[16] *The Winkfield* [1902] P. 42; *Hepburn v. A. Tomlinson (Hauliers) Ltd* [1966] A.C. 451. *Cf.* also *The Albazero* [1977] A.C. 744 at p. 845.

[17] (1881) 18 Ch. D. 1 (C.A.). The result was that the purchaser paid the full purchase price despite the damage to the property, while the insurer, by virtue of his right of subrogation, was able to recover back the payment under the policy: *Castellain v. Preston* (1883) 11 Q.B.D 380. For a different approach see the American case *Skelly Oil Co. v. Ashmore* 265 S.W. 2d 582 (Mo. 1963).

[18] Law of Property Act 1925, s.47.

[19] *Lake v. Baylis* [1974] 1 W.L.R. 1073 (recovery based on the purchaser's equitable ownership in the property). American decisions include *Gassner v. Lockett* 101 So. 2d 33 (Fla. 1958); *Timko v. Useful Homes Corp.* 114 N. J. Eq. 433, 168 A. 824 (1933). See also Palmer, *Law of Restitution* (1978), vol. 1, p. 439; Friedmann, *supra*, n. 15 at pp. 516 *et seq.*

[20] *Darlington B. C. v. Wiltshier Northern Ltd* [1995] 1 W.L.R. 68. *Cf.* also *Linden Gardens Trust Ltd v. Lenesta Sludge Disposals Ltd* [1994] 1 A.C. 85, discussed by Ian Duncan Wallace in (1994) 110 L.Q.R. 42.

[21] Friedmann, *supra*, n. 15; Farnsworth, "Your Loss or My Gain? The Dilemma of the Disgorgement Principle in Breach of Contract" (1985) 94 Yale L.J. 1339; Jones, "The Recovery of Benefits Gained from a Breach of Contract" (1983) 99 L.Q.R. 443; Beatson, *The Use and Abuse of Unjust Enrichment* (1991) at pp. 15–17.

[22] *Surrey County Council v. Bredero Homes Ltd* [1993] 1 W.L.R. 1361; but *cf. Jaggard v. Sawyer* [1995] 1 W.L.R. 269. See also O'Dair, "Restitutionary Damages for Breach of Contract and the Theory of Efficient Breach: Some Reflections" [1993] C.L.P. 113; Smith, "Disgorgement of the Profits of Breach of Contract: Property, Contract and Efficient Breach" (1994) 23 Can Bus L.J. 121; Birks, (1993) 109 L.Q.R. 518. Recovery of profits gained by breach of a contract was allowed by the Supreme Court of Israel in *Adras Ltd v. Harlow GmbH* (1988) 42(1) P.D. 221, discussed by Friedmann in (1988) 104 L.Q.R. 383.

[23] *Lake v. Baylis* [1974] 1 W.L.R. 1073; *Snepp v. United States* 444 U.S. 507 (1980); *Att.-Gen. v. Guardian Newspapers Ltd (No. 2)* [1990] 1 A.C 109 (the *Spycatcher* case), discussed in Jones, "Breach of Confidence after *Spycatcher*" [1989] C.L.P. 49.

means of the tort of inducement of breach of contract and also by equitable and restitutionary remedies.[24]

The Ranking of Interests and the New Terminology

As already indicated, there is but one genuine contractual interest. Needless to say that if it is observed, there is no room for any of the above mentioned remedies. Only if it is infringed do they come into play. Fuller and Perdue, however, identified three interests: the expectation interest, the reliance interest and the restitution interest. These interests were ranked in accordance with the strength of their claim for judicial intervention. Restitution arrived first and reliance second. The expectation interest ended at the bottom of the list.[25]

The expectation interest is simply an inappropriate term describing the performance interest. The other two have acquired the title "interest" probably under the influence of German law.[26] Whatever is the nature of reliance and restitution, they are certainly not contractual interests. Thus, the interest of a person who made a payment in order to get a house, a car or even a pizza is to get the house, the car or the pizza. Such a person will be greatly surprised to learn that upon contracting to purchase a house, he acquired an interest in getting his payment back (restitution interest). In all probability he is likely to protest that this is not what he wanted. Had he preferred the money to the house he would not have made the contract in the first place. He would need a lot of coaching in an American course on contracts to learn that his interest in getting his payment back ranks higher in the hierarchy than his interest in getting the house.

Indeed, the use of the term "interest" to describe restitution or reliance is somewhat problematic.[27] If we understand "interest" to reflect the purpose or the reason for entering the contract, then performance is the only genuine contractual interest. No doubt, if the contract fails, the party involved may wish to salvage what he can and thus settle for the recovery of the payment he made under the contract or his reliance losses. Such a recovery merely protects the interest *not to suffer a loss* in the course of an activity.[28] It has little to do

[24] Friedmann, "The Efficient Breach Fallacy" (1989) 18 J. Legal Stud. 1 at pp. 20–23. In addition, in American law punitive or exemplary damages, which are aimed at deterring breach and thus indirectly protect the performance interest, are sometimes available. See Farnsworth, *Contracts* (2nd ed., 1990); pp. 875 *et seq*. However, under English law this possibility seems to be excluded: *A. B. v. South West Water Services Ltd* [1993] Q.B. 507 (C.A.)

[25] Fuller and Perdue, at p. 56. For a criticism of this article see Stoljar, "Promise, Expectation and Agreement" [1988] C.L.J. 193. The ranking of the interests is criticised, from a different angle, in Epstein, "Beyond Foreseeability: Consequential Damages in the Law of Contract" (1989) 18 J. Legal Stud. 105 at pp. 107–108 (1989).

[26] See *infra*, text to n. 30.

[27] The term seems to infiltrate into English law. See *Surrey County Council v. Bredero Homes Ltd* [1993] 1 W.L.R. 1361 at p. 1369 (*per* Steyn L.J.).

[28] Hence, the German term "negatives Interesse". See *infra*, text to n. 30.

with the purpose of the activity (in the present context, the formation of the contract) or the interest in undertaking it.

This ranking of interest was apparently meant to contribute to one of the cardinal themes of the article, namely the belittling of the performance interest. It left, however, hardly any imprint. What proved of greater significance and of more lasting influence, was the introduction of new terminology.

One innovation, already noticed, was the addition of the word "interest" to the three terms used, so that, for example, "restitution" became "restitution interest". Of much greater importance were the terms themselves. There was nothing new about the term "restitution". The idea of reliance was also well known before Fuller and Perdue, and had attracted considerable attention.[29] However, Fuller and Perdue not only made it a term of art, but tried to elevate it to a kind of dogma.

It may also be noted that the terms "reliance interest" and "expectation interest" correspond to the German terms "negatives Interesse" and "positives Interesse" of which Fuller was clearly well aware.[30] In fact, the German synonyms to these terms are "Vertrauen interesse", *i.e.* reliance interest, and "Erfüllugsinteresse", *i.e.* performance interest.[31] The German word "Interesse" was literally translated as "interest", and the term "reliance" exactly corresponds to the German term "Vertrauen", though I do not know whether Fuller was aware of the use of "Vertraueninteresse" in German law and whether the adoption of the term "reliance" was reached without cognisance of the equivalent German term.

The greatest terminological innovation of Fuller and Perdue and the most inappropriate one, was the invention of "expectation"[32] or "expectancy". This term, which bears no resemblance to any German origin, was used to describe the normal measure of contractual damages, namely, the measure based upon the right to get the promised performance. The terms which at that time were in use to describe the performance (or expectation) damages included "compensatory damages", sometimes described as the "benefit of the bargain" or the "loss of the bargain". These terms are still being used

[29] It was discussed by Gardner, *supra*, n. 9, and in Cohen, "The Basis of Contract" (1933) 46 Harv.L.R. 553 at p. 578 (1933). See also Rakoff, *supra*, n. 8, and *infra*, text to nn. 108–110.

[30] See Fuller and Perdue at p. 55, n. 4. See also *Surrey County Council v. Bredero Homes Ltd* [1993] 1 W.L.R. 1361 at p. 1369 in which Steyn L.J. used the German terms in conjunction with those of Fuller and Perdue.

[31] These terms were used in German law long before Fuller and Perdue. See, *e.g.* Enneccerus, *Lehrbuch des Bürgerlichen Rechts* vol. 1 (6–8th ed., 1912), p. 28. They are still in use: see Schlechtriem, *Schuldrecht Allgemeiner Teil* (Tübingen, 1992) p. 96.

[32] The term "expectation" was occasionally used before Fuller and Perdue's article to describe the plaintiff's contractual interest. See, *e.g.* Cohen, *supra*, n. 29 at p. 580. But there seems to have been no previous attempt to turn it into a term of art.

in English legal literature,[33] but even there we find that the term "expectation damages" is gradually becoming more common.[34]

Fuller and Perdue wasted little time before assailing "compensatory damages" and offering a replacement. "The purpose of granting damages", we are told on the very first page of this article, "is to make 'compensation' for injury". But in the case of breach of contract "we compensate the plaintiff by giving him something he never had. This seems on the face of things a queer kind of 'compensation' ".[35] The plaintiff who has been deprived of his contractual right, is thus described as being compensated for "something he never had" [*sic*], and his contractual entitlement is regarded as something that never belonged to him.

Fuller and Perdue then suggest that "We can . . . make the term 'compensation' seem appropriate by saying that the defendant's breach 'deprived' the plaintiff of the expectancy".[36] It is perhaps fortunate that Fuller and Perdue did not devote more attention, as they should have, to specific performance. Otherwise we might have faced an analogical question to that presented in the context of damages, namely, why should the law ever force the defendant to grant the plaintiff something he never had? We might have also got an innovative term to replace "specific performance" such as "specific enforcement of expectations".

In fact one can hardly conceive of a term that is less appropriate than "expectancy" or "expectation". "Expectancy" is often used to describe a prospect or a probability of receiving a benefit in the future, *when this possibility is not supported by a legal right*.[37] The term usually relates to a contingency which falls short of a legal right and is to be distinguished from a "vested right" as, *e.g.* in the case of an expectant heir.[38] It has also been rightly pointed out that "in many tort actions the plaintiff can recover damages for loss of expectations:

[33] Treitel, *Law of Contract* (9th ed., 1995), p. 846. For the use of such terms in American legal literature see *infra*, n. 67. This however is done in the field of torts, in which Fuller and Perdue's terminology has not yet won the day.

[34] See, *e.g.* Treitel, *Remedies for Breach of Contract* (1988), p. 88; Burrows, "Contract, Tort and Restitution—a Satisfactory Division or Not?" (1983) 99 L.Q.R. 217; Bridge, *supra*, n. 14. See also *Surrey County Council v. Bredero Holmes Ltd* [1993] 1 W.L.R 1361 at p. 1369 (*per* Steyn L.J.).

[35] Fuller and Perdue, p. 53.

[36] *ibid.*

[37] Thus, a well known problem of insurance law is the extent to which expectation, as distinguished from legal right, can create an insurable interest: see *Lucena v. Craufurd* (1805) 2 Bos. and P.N.R. 269. Indeed, in that case Lord Eldon contrasted "a right derived under a contract and a mere expectation or hope"; at p. 321. See also Keeton and Widiss, *Insurance Law* (1988), pp. 144 *et seq.* *Cf.* also the distinction developed in English public law between rights and "legitimate expectations" which are accorded some protection (notably procedural protection such as a right to a hearing), but this protection falls short of that granted to rights. See *Council of Civil Service Unions v. Minister for Civil Service* [1985] A.C. 374 at p. 412 (*per* Lord Diplock). *Cf.* also *R. v. Secretary of State for Transport, ex p. Richmond-upon-Thames L.B.C.* [1994] 1 W.L.R. 74 at pp. 93–94; Craig, *Administrative Law* (3rd ed., 1994) pp. 293–296, 672–675.

[38] *Black's Law Dictionary* (6th ed., 1990), definition of the term "expectancy".

e.g. for loss of expected earnings suffered as a result of personal injury . . . "[39] Indeed, the term "expectation" may be more appropriate in this context, in which the expectation is not based upon a legal right,[40] than in the contractual context, in which the plaintiff has a legal right to receive that which was promised to him.

The Marginalisation of the Performance Interest

The next step in Fuller and Perdue's derogation of the right to performance comes in the process of the ranking of interests, in which the performance interest (now already diminished to mere "expectancy") is outclassed by both restitution and reliance. That being accomplished, there comes a question which casts doubts upon the very legitimacy of the right to performance. The subtitle on page 57 of the article reads: "Why Should the Law Ever Protect the Expectation Interest?" This is followed by a rather detailed discussion in which expectation again does not fare too well. In essence, three explanations are offered. One is psychological (the promisee's sense of injury); the second is based on the "will theory", which in Fuller and Perdue's view "has some bearing on the problem of contract damages" but there is "no necessary contradiction between the will theory and a rule which limited contract damages to the reliance interest".[41] The fallacy of this argument is examined below.

The third and only justification which Fuller and Perdue find for what they term "expectation" damages lies in the "difficulties in proving reliance and subjecting it to pecuniary measurement. . . . To encourage reliance we must therefore dispense with its proof."[42] Performance damages, thus, receive an additional blow. They are not justified in their own right. They are merely parasitic and exist because of the difficulties in measuring the "real" interest, namely reliance.

The argument is most unconvincing. The proof of reliance losses is by no means more difficult than proof of performance (or "expectation") losses, even if they are to include "loss of opportunity". However, in order to justify the adoption of the performance measurement, Fuller and Perdue must elevate this difficulty to the level of "impossibility".[43] There is more than one flaw in this argument. The appraisal of the performance interest is no less difficult, since it requires an answer to a hypothetical question, namely, what would

[39] Treitel, *supra* note 33 at p. 846.

[40] This type of situation arises where the plaintiff has no contract which guarantees his future earnings and recovery is based on the ground that he has every prospect of being employed.

[41] Fuller and Perdue, p. 58.

[42] Fuller and Perdue, p. 62.

[43] Fuller and Perdue, p. 60.

have been the plaintiff's position had the contract been performed. Indeed, performance damages may include compensation for lost opportunities, namely, opportunities which the plaintiff would have realised had the contract been performed. There is no reason to assume that measurement of these lost opportunities is feasible, whereas in the context of reliance it is not.[44] Moreover, since reliance damages are awarded in appropriate cases, indeed Fuller and Perdue advocated their expansion, it seems that their measurement does not present insurmountable problems.[45] In fact, reliance damages are sometimes awarded on the ground that it is impossible to appraise the performance, or "loss of the bargain", damages.[46] This, of course, is the very opposite of the argument made by Fuller and Perdue.[47]

The difficulties with Fuller and Perdue's reasoning is, however, more fundamental. As already indicated, they accept the "will theory" and the premise that a contractual promise is legally binding. They assume, however, that the question of the remedy is completely divorced from the nature of the right. It is, therefore, open to prefer the reliance measure of damages to that of the performance (in their terminology "expectation"). The reasoning is, however, most unconvincing. It is, of course, legitimate to examine the grounds for recognising the binding effect of contracts. This was done in a leading article published three years before Fuller and Perdue's[48] and the issue is constantly re-examined. However, Fuller and Perdue avoided this question. They accepted the validity of the contractual obligation but erroneously assumed that it entails few consequences as to the remedy.[49]

It is, of course, true that the mere recognition of a specific right does not provide answers to all issues regarding the remedies available for its protection. Thus, the fact that the legal system recognises the right of ownership does not tell us whether the owner, whose property was misappropriated, will be entitled to restitution *in specie*

[44] See *e.g. East v. Maurer* [1991] 1 W.L.R. 461 (C.A.), noted by Marks (1992) 108 L.Q.R. 387, in which the plaintiff purchased the defendant's hairdressing saloon after the latter made a false representation as to his working plans. In an action for deceit the plaintiff recovered damages for "reliance losses" which included "loss of opportunity" (to use Fuller and Perdue's terminology), namely loss of profits which the plaintiff would have realised had he purchased another hairdressing business. On the issue of "lost opportunity" and the appraisal of the value of an alternative bargain, see Bridge, *supra*, n. 14 at pp. 430–433.

[45] This difficulty is to some extent avoided through the inconsistency in the definition of reliance losses. When they are awarded, they often assume a narrow meaning which does not include loss of opportunities. See *infra*, text after n. 115.

[46] *Anglia Television Ltd v. Reed* [1972] 1 Q.B. 60; *CCC Films Ltd v. Impact Quadrant Films Ltd* [1985] Q.B. 16.

[47] But again, the award relates to "reliance damages" in the narrow sense. See *supra*, n. 45.

[48] Cohen, *supra*, n. 29.

[49] See *supra*, text to n. 41 where reference is made to Fuller and Perdue's view that the will theory, which attempts to explain the validity of the contractual obligation, does not tell us whether recovery should be based upon reliance or expectation.

or merely to damages. The rules on remoteness of damages are similarly not self evident. It is, however, an unwarranted jump to conclude that the right tells us *nothing* about the remedy and that rights and remedies raise totally unrelated issues.

It is submitted that the very recognition of a legal right entails some consequences regarding the remedy, one of which relates to the initial point of inquiry. This initial point relates to the value of legal right, at least where such value can be ascertained. The right of recovery may be qualified or subject to exceptions. The initial point is, however, clear.

Thus, suppose that P acquired for $300 shares which are now worth $1000. The shares have been misappropriated by D. In Fuller and Perdue's terminology the $300 represents "reliance loss" whereas the $1000 represents "expectation damages". After all, P never had the $1000. He had shares which he could expect to sell. This expectation, if realised, would yield him $1000.[50] However, the translation of the situation into Fuller and Perdue's terminology merely confuses the issue. The historical expenditure or the reliance interest (in the above example, $300) is irrelevant, except where it serves as evidence of existing value. Recovery is based upon the present value of the shares. The recognition of P's right of property suffices to justify such recovery.

It is clearly legitimate to question the justification of private property. However, once private ownership is recognised, it follows as a matter of course that the owner whose property has been misappropriated will either recover it *in specie* or will get damages reflecting its value.[51] In order to justify this result, there is no need to resort to the "lost opportunity" explanation (the owner could have brought other shares that might have similarly appreciated in value) or to some other fiction.

Let us now revert to the contract situation. Suppose that in consideration of $300 D undertook to transfer to P, within 6 months, certain shares. After 5 months, when the price of the shares reaches $1000, D reneges. If we assume that the contract was valid so that it vested in P the right to the promised performance, it follows that P would be entitled either to specific performance (the value of which is $1000) or to the substitutionary remedy of damages, which will be based upon the value of the promised performance, namely $1000.[52]

This argument, as well as the analogy to property, is strengthened

[50] Fuller and Perdue were clearly aware of the possibility that even property interests could be described as an "expectancy": see p. 59, n. 10.

[51] A number of questions may remain open, such as the question whether the relevant date of appraisal is the date of the wrong or some other date. The initial point is, however, clear.

[52] On the relevance of specific performance to the measurement of damages see also Waddams, *Law of Damages* (1983), pp. 313–314.

by the possibility of assignment. In the property example P could sell the shares for $1000. In the contract example he could have assigned his contractual right to receive the shares for a similar amount. In both instances, the measure of recovery ought, therefore, to be similar. To claim that the contract was binding, *i.e.* that P was entitled to D's performance, and yet that recovery can be confined to P's expenditure ($300), is a contradiction in terms.[53]

Fuller and Perdue feel, however, that the obvious result needs explanation. The superfluous explanation is based upon the lost opportunity theory, which forms part of the reliance loss. Because P entered into contract no. 1 with D, he gave up the possibility of another potential contract (contract no. 2) with a third party (T) which would have yielded him similar gains. The argument is doubly flawed. First, if P's gains from the actual contract (no. 1) with D are not recoverable in their own right as part of his performance (or "expectation") interest, why do these very gains become recoverable when attributed to another potential contract (contract no. 2)?[54] Is it because they have changed denomination and appear under the guise of reliance? Second, the whole argument is based on circular reasoning. If it is assumed that the entitlement to recover performance (expectation) damages in contract no. 1 derives solely from the lost opportunity (potential contract no. 2), we have to examine the value of this opportunity. This is obviously dependent upon the nature of the entitlement and the ensuing measure of damages in potential contract no. 2. If there is no justification for performance damages (other than lost opportunity) then the value of contract no. 2 was not $1000, but a mere $300,[55] unless we assume that the recovery will again be based on lost opportunity (potential contract no. 3) and so *ad infinitum*.

The Value of the Legal Right and the Measure of Damages in Contract and Tort

Fuller and Perdue raise the question whether broad adoption in contracts of the so called "tort principle", namely, the reliance interest, would not "blur the lines of division separating the different branches of the law". In their view the breaking of the barriers between the

[53] A way which offers some support to Fuller and Perdue's approach is to follow the line suggested by Holmes, according to which the contract does not create a right to performance but merely a right to damages if the promises event does not happen to pass: Holmes, *The Common Law* (1881), p. 301. But this position is untenable and it is now universally accepted that damages are merely a substitutional remedy: Farnsworth, *Contracts* (2nd ed., 1990), pp. 844–845; Treitel, *Remedies for Breach of Contract* (1988), p. 75. This means that the contractual right is a right to performance. See also Friedmann, "The Efficient Breach Fallacy" (1989) 18 J. Legal Stud. 1.

[54] *Cf.* also Rakoff, *supra*, n. 8 at p. 221.

[55] *Cf.* Bridge, *supra*, n. 14 at pp. 430–431 who suggests that "the recoverable sum should be (slightly) discounted to reflect the risk that an alternative seller might also have defaulted".

branches of the law of obligations "would represent a distinct service to legal thinking".[56]

The basic assumption that there exists, on this specific point, such a barrier between tort and contract damages, is, however, erroneous. It is assumed that tort damages look backwards and aim at returning the plaintiff to the *status quo ante* whereas contract damages look forward and strive to put the plaintiff in the position in which he would have been had the contract been performed. Reliance damages are, thus, akin to the tort principle since they are meant to put the plaintiff in his pre-contract position, whereas performance damages reflect the contract principle.

This analysis is based on a misconception which derives from the failure to adequately distinguish between rights and remedies. It is submitted that *the basic principle as to damages is identical in contract and tort*, though there may be some variations in its application.[57] This principle provides in essence that the purpose of damages is to put the plaintiff, in economic terms, in the position in which he would have been had the wrong (either a tort or breach of contract) not been committed. *The different results reached in tort and contract derive from the fact that they are usually called on to protect different rights*. Where, however, they are invoked to protect the same right, the calculation of damages, which reflect the value of this right, either in tort or in contract will be similar.[58] The point can be demonstrated by the following examples:

> Example (1): D, a doctor, treats his patient P negligently. As a result, P's condition deteriorates.

D is liable in tort, and if he acted under a contract with P his liability is also in contract. The measure of damages in contract and in tort will be the same. It will aim to put P in the position in which he would have been had he been treated with due care. The reason for the identical result is that the defendant's duty and the corresponding entitlement of the plaintiff are the same in contract and tort, namely, that the medical treatment will be given with due care.[59]

[56] Fuller and Perdue at p. 419. As indicated *supra*, n. 9, the point that reliance damages reflect the "tort principle" was already made by Gardner.

[57] Thus, there may for example be a difference with regard to the rules on remoteness of damages. Tort damages may also be awarded for items for which contract damages are either more limited or hardly available such as "mental distress" and punitive damages. The reason for this discrepancy is probably historical and stems from the fact that historically tort law was mainly concerned with physical injuries while contract law dealt mainly with economic losses.

[58] As to possible differences regarding other damages items see *supra*, n. 57.

[59] See *e.g. Thake v. Maurice* [1986] Q.B. 644 (C.A.) in which the plaintiffs, a husband and a wife, contracted with a surgeon that he would perform a vasectomy operation on the husband. The surgeon described the operation as irreversible but failed to warn the plaintiffs that there was a small risk that the husband would become fertile again. It was held that this failure amounted to negligent breach of the duty of care both in contract and in tort. Since the duty in contract was identical to that in tort the measure of damages in either of these branches was also the same. Kerr L.J.,

> Example (2): The same facts as in Example (1) except that D gave an absolute contractual undertaking that P's situation would improve as a result of the treatment. D treated P with due care but failed to achieve the promised result.

In this example the results in contract and tort will diverge. P has no cause of action in tort. He is entitled to claim in contract, and recovery ought in principle to be based upon the performance (expectation) interest, *i.e.* the difference between his present situation and the situation he would have been in had the promise made to him been fulfilled.[60] The reason for the different measure of recovery does not stem from a difference between the principles of damages in contract and in tort but from a *difference in the entitlements*. Had the entitlements been similar (as in Example (1)), the measure of damages would also be the same.[61]

> Example (3): P paid D $300 for shares which D undertook to transfer to him after 6 months. After 5 months D repudiates the contract. At this time the shares are worth $1000.
>
> Example (4): Same facts as in example (3) except that D's breach was wrongfully induced by a third party (T).

In Example (3) P's claim against D is in contract. In Example (4) P has also a claim in tort against T. In both instances damages will reflect the performance ("expectation") interest, *i.e.* $1000. The fact that the result in tort and contract is identical and that the award in tort reflects the performance interest[62] (rather than the reliance interest) is hardly surprising. The reason is simple. The contract created an entitlement to the promised performance. When tort law is called to protect this entitlement, the measure of damages will reflect its value. This result corresponds to that reached in the property situation already mentioned. In that case it was assumed that P had acquired ownership in the shares which were misappropriated by a

in a dissenting opinion, concluded that the contract included a promise that the operation would achieve a specific result, namely that the husband would become permanently sterile. Obviously, if the contract embodied a wider entitlement than that obtaining under tort law, the measure of damages in these two branches will differ, and in this particular case damages in contract would have been higher (*ibid.* at p. 683). *Cf.* also *infra*, Examples (5) and (6), which deal with pure economic loss. The position is *a fortiori* in cases of physical injury.

[60] *Cf. Thake v. Maurice, supra*, n. 59. *Cf.* also *Hawkins v. McGee* 84 N.H. 114, 146 A. 641 (1929). For a discussion see Cooter and Eisenberg, "Damages for Breach of Contract" (1985) 73 Cal.L.Rev. 1432 at pp. 1436 *et seq*. But see *Sullivan v. O'Connor* 363 Mass. 579, 296 N.E. 2d 183 (1973) discussed *infra*, text to n. 92.

[61] Even in Example (2) the measure of recovery is dependent upon the nature of D's promise. Thus a promise under which D did not assume the whole risk of a successful operation may confer upon P a more limited entitlement, the breach of which will lead only to the recovery of reliance damages. See *Restatement 2d, Contracts*, §351 comment *f*.

[62] McGregor, *Damages* (15th ed., 1988), p. 1070 (damages for inducement of breach of contract include loss of profits, which "may be the profit that the plaintiff would have made on the contract the breach of which the defendant has induced").

third party. Recovery in tort is based on the value of the misappropriated shares, rather than upon the price paid for them (the reliance expenditure). The similarity between the property and the contract situation is conspicuous. In both an entitlement has been created and in both the measure of recovery in tort will be similar.

> Example (5): T intends to bequeath property to P. He instructs his lawyer, D, to prepare a will accordingly. D negligently delays the preparation of the will and T dies without having signed it; or D prepares the will negligently so that it is invalid.

In this type of situation it has usually been held that the negligent lawyer (D) is liable to the intended beneficiary (P),[63] and the tendency in common law jurisdictions is to ground this liability in tort.[64] It is, however, obvious that although liability is in tort, recovery includes "expectation losses" and is not confined to "reliance losses". The damages recovered are, thus, equal to those which would have been awarded had liability been based upon contract.[65] One possible explanation is that in this type of situation tort law is utilised to remedy a shortcoming in contract law, according to which D's contractual obligation is only to T and not to P. There is another way of explaining this result. In P-T relations P has a mere expectancy. T is under no obligation to make a will in P's favour, and even if he did, he is usually free to revoke it. "Expectation" is, thus, the proper term describing P's position *vis-à-vis* T. The situation is, however, totally different with regard to P-D relations. D is under a duty towards P. This duty, enforced via the law of tort, reflects P's entitlement *vis-à-vis* D that the latter will not wilfully or negligently frustrate P's expectation to the inheritance. If this duty is breached, P may recover the value of that of which he was deprived. The reason that in this case tort damages are basically equal to the damages which would have been awarded, had there been a contract between the parties, is simply that the duty and the entitlement, recognised by tort law, are similar to the obligation and entitlement that a contract is likely to have created.

[63] This development culminated in England in the recent majority decision of the House of Lords in *White v. Jones* [1995] 2 W.L.R. 187, in which Lord Goff of Chieveley discusses the position of a number of common law jurisdictions as well as that in German law. See also *Ross v. Caunters* [1980] Ch. 297; *Biakanja v. Irving* 320 P. 2d 685 (1958) (California); *Lucas v. Hamm* 364 P. 2d 685 (1961) (California); *Gartside v. Sheffield, Young & Ellis* [1983] N.Z.L.R. 37. For a survey of American cases see Annotations in 61 A.L.R. (4th) 464 and 61 A.L.R. (4th) 615 (both by J. Teshima).

[64] This position was adopted in all the cases referred to, *supra*, n. 63, but in *Lucas v. Hamm* the court also accepted the contractual, third party beneficiary, theory. Regarding the various theories of liability, adopted in American case law, see Annotation in 61 A.L.R. (4th) 615 at pp. 661 *et seq*. (third party beneficiary), 673 *et seq*. (negligence or breach of duty) (J. Teshima).

[65] See also *White v. Jones*, *supra*, n. 63 at p. 207, where Lord Goff stated that damages for loss of expectations are not excluded in cases of negligence, and that he could not see that "for the present purposes, any relevant distinction can be drawn between the two forms of action" (*i.e.* contract and tort).

> Example (6): D negligently misrepresents the qualities of a machine which he offers to sell to P for $10000. P invests $500 in adapting his factory building for the use of this machine. However, before the contract is concluded P finds that the machine does not have the described qualities and he declines to buy it. Had the machine possessed the qualities which D stated, it would have been worth $14000.

P's claim in tort is limited to $500 (the reliance expenditure). He is not entitled to recover $4000 ("expectation damages").[66] This limitation does not derive from the application of the "tort measure" of recovery.[67] Examples (4) and (5) demonstrate that damages in tort may include performance (or "expectation") losses. The award of mere reliance damages in Example (6) is predicated on the ground that P did not acquire an entitlement to D's performance (the value of which would have been $14000). Such an entitlement would have been created had a contract, in which the seller guarantees the machine's performance, been formed.[68]

In other words, the distinction between Examples (4) and (5) on the one hand, and Example (6) on the other hand, is that the protected interest in the latter example is more narrow. It does not include an entitlement to a promised performance but merely a right not to be misled by mis-statements or even by non-binding promises. It is thus submitted that *the distinction between tort and contract does not lie in differences in the basic principle of damages recovery but in the different nature of the entitlements that are usually involved.* The distinction derives from the fundamental function of contract law, namely, the recognition and the ordering of entitlements created by the parties' binding promises.

Hence, the disparity between contract and tort relates to the creation of rights and obligations rather than to the principles of measuring their value for the purpose of damages. As already indicated,

[66] Treitel, *Law of Contract* (9th ed., 1995), at pp. 333–335. *Cf.* also Illustration (8) to §90 of the *Restatement 2d, Contracts*.

[67] *East v. Maurer, supra*, n. 44. However, under the prevailing view in American law recovery, in case of fraud, is to be based upon the expectation interest. See Prosser and Keeton, *Torts* (5th ed. 1984), pp. 767–768. Incidentally, Prosser and Keeton still use the pre-Fuller and Perdue terminology and speak of "loss of bargain" (rather than "expectation") rule.

[68] It is, however, conceivable for a contract to be formed which will impose a more limited liability, so that liability in contract will not exceed that imposed via the law of tort. *Cf.* also *Esso Petroleum Co. Ltd v. Mardon* [1976] Q.B. 801 in which a tenant took a lease of a petrol station. In the pre-contractual negotiation a representative of Esso told the tenant about the estimate made by Esso as to the potential quantity of petrol that could be sold on this station. This forecast had been negligently made. It was held that this amounted to breach of a collateral warranty (*i.e.*, breach of contract) and to negligent misrepresentation (tort), and that the damages recoverable in contract and in tort were precisely the same. The reason is that the contract did not guarantee the throughput but merely that the forecast was made with reasonable care and skill, and since the duties in contract and tort were identical, so were the damages in each of these branches. See also *Thake v. Maurice, supra*, n. 59.

once a valid legal right has been created in accordance with the prevailing rules of contract law, the damages available for its protection is case of breach, either in contract or in tort, will be similar.

RIGHTS, REMEDIES AND §90 OF THE RESTATEMENT, CONTRACTS

In this context let us briefly examine the problem raised by the wording of §90 of the *Restatement, Contracts*. Fuller and Perdue criticised Williston's position, who in their view assumed that the performance (expectation) damages rule "is the only permissible rule of recovery even in the case of promises made enforceable by §90 . . . ".[69] For Fuller and Perdue this article offered the strongest proof of the separation between rights and remedies and that the recognition of the binding effect of a contract does not entail the adoption of the performance measure of damages. A substantial part of the American Law Institute debate on this section was devoted to the hypothetical case in which Johnny's uncle promises him $1000 to buy a car. Johnny buys a car for $500. Is the uncle liable and if so, is his liability limited to $500? Williston's position was that if the promise is binding, then liability is for the whole amount of $1000. It should, however, be pointed out that Williston did not exclude a more limited recovery. His position was that where the promise becomes binding, so that it is regarded as a contractual promise, then it follows that recovery is for the whole amount. Indeed, it may be added that in this example the claim for $1000 is not for damages but simply for common law specific performance.[70]

Williston seems to have conceded that a recovery of a smaller amount is conceivable. But his point was that in such a case the recovery is not in contract but is founded in another concept.[71] The difficulty stems from the words of §90 that describe the promise as "*binding* if injustice can be avoided only by *enforcement* of the promise". In view of this wording Williston's position was clearly correct. If the promise is "binding" it means that the promisee is entitled to its performance (or to performance damages).[72] This view is strengthened by the ensuing words that speak of the *enforcement* of the promise. The difficulty has been only partially alleviated by the

[69] Fuller and Perdue, p. 64.

[70] See *supra*, text to nn. 11–12 regarding the recovery of debts (common law specific performance).

[71] The debate is reprinted in Linzer, *A Contracts Anthology* (1989), pp. 222–232. At one stage one of the participants, McDermott, suggested that in this case injustice might be avoided if the uncle made a tender of $500. Williston immediately agreed and added that the same result might ensue if the uncle succeeded in convincing the dealer to take the car back (*ibid.*, at p. 230). Williston, thus, accepted the possibility of partial liability. His point was that in such a case the promise was not contractually binding. It merely entailed liability to prevent the injustice.

[72] Yet, even in such a case the promisor, when making the promise, may limit his liability. See *supra*, n. 61.

Restatement 2d, Contracts, which added the statement under which "The remedy granted for breach may be limited as justice requires". In fact there is an incongruity between this statement and the preceding words which describe the promise as "binding" so that injustice can be avoided only by its *enforcement*.[73] It is, however, clear that in case of a conflict, the last sentence, which permits the remedy to be limited, prevails.

In essence, the difficulty stems from an imprecise definition of the legal right and the corresponding duty or obligation. It would have been avoided if instead of defining the promise as binding, a duty of good faith in negotiation or in making promises had been imposed. In fact, §90 deals with different types of entitlements. In some instances in which the entitlement is indeed to performance, it may be regarded as a contractual entitlement. In other instances, in which there is a mere right not to be misled by a promise that is later broken, the remedy is limited accordingly. However, the drafting of §90 reflects the traditional Anglo-American approach which places the emphasis upon the remedy and leaves the nature of the right in obscurity.

The Difficulties with Fuller and Perdue's Reliance Concept

The term and the very concept had been well known before Fuller and Perdue's famous article.[74] Fuller and Perdue sought to offer a precise definition of this concept, to broaden its meaning by the inclusion of "lost opportunities", and to place it at the very centre of contract law. The term itself is convenient and attractive. The main difficulty lies in its ambiguity.[75] Fuller and Perdue distinguished between "essential reliance" and "incidental reliance". These are rather unhappy terms since they hardly convey a clue to their intended meaning. In essence "essential reliance" reflects losses and expenditures incurred by one party in order to acquire that which was promised by the other party (*e.g.* payment made to the other party, expenses incurred in preparation to perform the contract). It is, in other words, "acquisition reliance".[76]

The other type of reliance, "incidental reliance", refers to the reliance upon the promised performance. For example, the defendant promises to provide the plaintiff with storing space. In reliance on this promise the plaintiff acquires a stock of goods. The defendant breaches his promise and the plaintiff, who is unable to store them

[73] Eisenberg, "Donative Promises" (1979) 47 U. Chi. L. Rev. 1.
[74] *Supra*, n. 9; *infra*, n. 109 and accompanying text.
[75] *Cf.* also Kelly, "The Phantom Reliance Interest In Contract Damages" [1992] Wis.L.Rev. 1775 at p. 1768.
[76] This type of reliance has been described as the "price" the party is required to pay: Farnsworth, *supra*, n. 53 at p. 842.

elsewhere, suffers a loss.[77] It may, thus, be termed "performance reliance". This reliance also includes most cases of lost opportunity, which Fuller and Perdue included in their reliance interest, *e.g.* because the plaintiff contracted to purchase the defendant's house, he gave up an opportunity of buying another house from a third party.

It is conspicuous that "acquisition reliance" is close to restitution, though it is somewhat broader, since it includes not only expenditures that enrich the other party but also expenses and losses that are of no benefit to him. "Performance reliance" is very close to the performance (expectation) interest (notably if it includes lost opportunities), though it is somewhat narrower. The difference lies in those situations in which there has been no reliance. But even this difference becomes blurred if the requirement of *actual* reliance is dispensed with and replaced by "abstract" or presumed reliance.[78] Indeed, reliance and performance would become precisely identical if the promisee is irrefutably presumed to have relied on his receiving the promised performance.[79] There are some passages in Fuller and Perdue that seem to allude to "abstract" or presumed reliance. It is, thus, stated with regard to lost opportunities that "the impossibility of subjecting this type of reliance to any kind of measurement may justify a categorical rule granting the value of the expectancy . . ."[80] Shortly afterwards we find support for "a policy in favor of promoting and facilitating reliance on business agreements".[81] Needless to say, this policy receives its strongest support if such reliance is irrefutably presumed.

But while Fuller and Perdue in the first part of their article espouse reliance in its broadest possible meaning, there are other passages in the article in which reliance is used in a much narrower sense. This inconsistency, which has been pointed out by Todd Rakoff,[82] stems from a fundamental conflict between two major themes of the article.

[77] Fuller and Perdue, p. 77. This example is based upon *Nurse v. Barns* (1664) T. Raym 77. Thus, the issue of consequential damages, which arose in *Hadley v. Baxendale* (1854) 9 Exch. 341, relates to the ambit of recovery for "performance reliance". A parallel issue may arise with regard to "acquisition reliance" as, *e.g.* where the party, in order to make a payment required under the contract, sells property at a loss. Such a loss, which may be regarded as "too remote", constitutes an "acquisition reliance" loss.
[78] *Cf.* also Rakoff, *supra*, n. 8 at p. 213 who speaks of the "notional" value of lost opportunities.
[79] A similar approach may be applied in the context of property. Suppose the plaintiff had a piece of property worth $100,000 which was destroyed by the defendant. The plaintiff's right to recover the amount can simply be based upon the fact that the defendant's wrong deprived him of something which he had and which was worth $100,000. It is also possible to use the "expectation" terminology and state that the plaintiff lost a piece of property that could be sold for this amount (*supra*, n. 50 and accompanying text). Another possibility is to use the reliance reasoning and suggest that the plaintiff relied upon him having this property (*e.g.* he used to spend more or work less in view of his ownership). Such reliance can, of course, be presumed.
[80] Fuller and Perdue, p. 60.
[81] Fuller and Perdue, p. 61.
[82] *Supra*, n. 8 at p. 213. See also Kelly, *supra*, n. 75 at pp. 1761 *et seq.*

The one suggests that reliance, rather than expectation, is the true basis of contract and that the expectation measure of damages actually represents reliance losses. For this end it is necessary to offer the widest definition to reliance so that it will actually match the expectation (performance) interest. The other theme rejects the "all or nothing" approach of contract law and offers partial recovery in the form of reliance damages. However, in order for reliance to fulfil this role, it must be sharply differentiated from performance (expectation) damages, and exclude some items included in expectation. Indeed, when reliance is called to fulfill its function as a yardstick for a modest award of damages, it becomes amazingly similar to the actual loss measure as described in the §333 of the *Restatement (1st), Contracts*, a provision which was severely criticised by Fuller and Perdue, precisely because it seemed to them too narrow.[83]

The Impact of Fuller and Perdue—Terminology and Substance

(*a*) *Terminological impact*

As already pointed out, the most significant effect of Fuller and Perdue lies in the introduction of a new terminology.[84] No student is likely to complete an American course on contracts without reciting "expectation interest" and "reliance interest". In recent years the new terminology has spread to England and to other Commonwealth jurisdictions, although the traditional terms such as "compensatory damages" or "loss of the bargain" are still in use.[85] Nowhere is the terminological transformation more conspicuous than in the *Restatement, Contracts*. The *Restatement (1st)* was published before Fuller and Perdue and was in fact the subject of rather acrimonious criticism in their article. In the index of this version there is no reference to the terms "reliance" or "expectation". They do not appear as separate items nor as subtitles to such terms as "damages" or "remedies". In fact I was unable to find that they were mentioned anywhere in the *Restatement (1st)*.

The change as reflected in the *Restatement 2d* is dramatic. The terms "reliance" and "expectation" appear in the index and the text is replete with them. It is particularly interesting to compare relevant sections of *Restatements (1st)* and *2d* in which there has been little or no change in substance, only to find that "expectation" and "reliance" either replaced the old terminology or were simply added.

[83] Fuller and Perdue, at p. 90.
[84] *Supra*, text to nn. 26 *et seq*.
[85] *Supra*, nn. 27; 32–34 and accompanying text.

Thus, for example, §347 of the *Restatement 2d* consolidates §329 and §335 of the *Restatement (1st)*.[86] The new section is somewhat differently worded and arranged, but there is no change in substance. What is, however, conspicuous is the terminological transformation. The old §329 was entitled "Compensatory Damages . . . " This proper term has now been dropped, probably because it had been the subject of Fuller and Perdue's unjustified criticism. Instead, the new §347 is entitled "Measure of Damages in General". The text of §347 reflects the triumph of the new terminology and states that subject to certain qualifications the injured party has a right to damages based on his "expectation interest". Needless to say that this term is not to be found in the old provisions of the *Restatement (1st)*.

Finally, since specific performance escaped Fuller and Perdue's attention, it retained its original denomination. This led to incongruity in the terms describing the two major remedies. The term for specific enforcement continues to embody a correct description of the protected interest (*i.e.* performance), whereas the substitutionary remedy (damages) is described by a different term that confers an inappropriate impression regarding the interest involved.

(*b*) *Substantive impact*

An attempt to appraise the effect of Fuller and Perdue's article is complex and may well be imprecise. It has been suggested that "*The Reliance Interest* has influenced American law less than we might expect, considering its prominence in casebooks and law reviews".[87] The view has also been expressed that "the reliance interest plays virtually no role in the calculation of damages in contract cases."[88] I think that these views are correct. For the purpose of our discussion it will be convenient to relate to each of the interests presented in the *Reliance Interest* article.

Performance (expectation). Fuller and Perdue did not expressly advocate the curtailment of the protection granted to the performance interest. However, much of the article consists of an attempt to question its justification, to describe it as an "expectancy" and to suggest that its legitimacy depends on reliance. They also hinted at the possibility of limiting recovery to reliance losses in certain cases in which a binding contract has been concluded, notably in situations that are not within the credit system.[89] Professor Atiyah went a step

[86] Reporter's note to §347 of the *Restatement 2d, Contracts*.
[87] Macaulay, *supra*, n. 2 at p. 266.
[88] Kelly, *supra*, n. 75 at p. 1758.
[89] Fuller and Perdue at pp. 65–66.

further. He was "troubled and uncertain about the extent to which executory contracts should be enforced, and the extent to which the expectation damages measure is appropriate . . . ".[90] He also considered that "it would not be surprising if future developments tend to show a still further whittling down of expectation damages."[91]

Modern law hardly reflects any traces of this approach. §351(3) of the *Restatement 2d, Contracts* provides that a court may in the interest of the justice, exclude or limit "recovery for loss of profits by allowing recovery only for loss incurred in reliance, or otherwise . . . ". The most notable decision in this direction is *Sullivan v. O'Connor*[92] in which a professional entertainer underwent plastic surgery to enhance her appearance. The result was, however, unhappy. The jury found that the surgeon was not negligent but he was held liable for breach of a contract to improve the plaintiff's appearance. The court's reasoning supports reliance-based damages. In fact, the plaintiff on appeal waived any claim for damages based upon the situation she would have been in, had the promise been fulfilled. The decision seems to represent an exception.[93] Moreover, where recovery falls short of the performance interest, it is not the reliance measure, at least not in the sense that Fuller and Perdue attributed to this term, which is applied. This point is examined below.[94]

However, the main thrust of modern law has been in the very opposite direction. Notwithstanding *The Reliance Interest* there are no signs of weakening of the performance interest. On the contrary, one of the major trends in modern contract law is the strengthening of the protection accorded to the performance interest.[95] Traditional limitations upon the availability of specific performance and upon the recovery of performance damages have either been removed or severely curtailed.

The scope of specific performance has spread beyond real estate cases to many other types of contracts. The traditional qualification under which specific performance will not be granted if damages are "adequate", has lost much of its potency. Indeed it has been sug-

[90] Atiyah, *Essays on Contract* (1987), Essay 7 at p. 178. In his view "bare consent, a bare promise, is a much less powerful source of obligation than induced reliance or actual benefits rendered." See *ibid.*, Essay 7 at p. 150.

[91] Atiyah, *The Rise and Fall of Freedom of Contract* (1979), p. 764. For a convincing reply see Waddams, *Law of Damages* (1983), pp. 313–316.

[92] 363 Mass. 579, 296 N.E. 2d 183 (1973). The case has been widely discussed. See Rakoff, *supra*, n. 8, pp. 241–242; Macaulay, *supra*, n. 2, pp. 279–281. Compare this decision with the English case *Thake v. Maurice*, *supra*, n. 59.

[93] A different result was reached in *Hawkins v. McGee* 4 N.H. 114, 146 A. 641 (1929). See also Farnsworth, *supra*, n. 53 at p. 934 saying that "few other courts have been equally frank in discussing the possibility of limiting recovery".

[94] *Infra*, text after n. 115.

[95] Friedmann, *supra*, n. 24.

gested that "the availability of specific performance depends on the *appropriateness* of the remedy . . . . The question is not simply whether damages are an 'adequate' remedy, but whether specific performance will 'do more perfect and complete justice than an award of damages.' "[96]

The law of damages shows similar signs of expanding the protection granted to the performance interest. The fundamental principle under which, so far as money can do it, the injured party should be placed in the same situation as if the contract had been performed, is constantly applied.[97] Furthermore, legal rules that have in the past limited the prospects of obtaining full performance damages seem to lose at least part of their effect. Thus, the traditional English rule regarding the date for the assessment of damages has been that of the date of the breach. The rule is disadvantageous to the plaintiff in periods of rising costs and inflation, notably if he lacks the means to make a substitute transaction. The traditional rule has now been attenuated. It is no longer absolute "and the court has power to fix such other date as may be appropriate in the circumstances".[98] A related development concerns the requirement of mitigation. The fact that the plaintiff lacks the means to mitigate the loss is not to be taken against him, at least if the result is regarded as being within the contemplation of the parties.[99]

Another development which reflects the strengthening of the performance interest relates to the measure of recovery where the defendant renders a defective performance or a performance which is not in line with the contract requirements. The cost of curing the defect is usually higher than the difference in market value between the performance as rendered and the value of the performance had it conformed to the terms of the contract. In this type of situation recovery was often confined to the difference in value, if the cost of cure was disproportionate to the difference in value.[100] However, the present tendency is to award the plaintiff the cost of repair even where there is a large disparity between this cost and the difference in

[96] Treitel, *supra*, n. 33 at p. 923 referring to *Tito v. Waddell (No. 2)* [1977] Ch. 106 at p. 322. For a parallel development in American law see Laycock, "The Death of Irreparable Injury Rule" (1990) 103 Harv.L.Rev. 687, who points out that equitable remedies, including specific performance, are no longer exceptional.

[97] See the references in Chitty, *Contracts* (27th ed., 1994), vol. 1, §26-001. See also *Darlington Borough Council v. Wiltshier Northern Ltd* [1995] 1 W.L.R. 68 at p. 80.

[98] *Johnson v. Agnew* [1980] A.C. 367 at p. 401. See also *Wroth v. Tyler* [1974] Ch. 30 in which damages were assessed by reference to the value at the time of judgment. The modification of the traditional rule is discussed in Waddams, "The Date of Assessment of Damages" (1981) 97 L.Q.R. 445.

[99] *Wroth v. Tyler*, *supra*, n. 98; Treitel, *Law of Contract* (9th ed., 1995), p. 877.

[100] *James v. Hutton* [1950] K.B. 9; *Tito v. Waddell (No. 2)* [1977] Ch. 106; McGregor, *Damages* (15th ed., 1988), 1092; Treitel, *supra*, n. 99 at pp. 852–855.

value, provided that it is reasonable for the plaintiff to insist on reinstatement.[101] Furthermore, circumstances are conceivable in which the costs of repair are unreasonable while the difference in value is small or even nil. Under the traditional approach, in such a case, the plaintiff might have been left without a remedy. The recent decision of the House of Lords in *Ruxley Electronics Ltd* indicates that these two measures of recovery are not exhaustive, and that damages might be awarded by reference to the fact that the plaintiff's performance interest has been frustrated by the defendant's breach. The court may, thus, be required to appraise an element that has no market price in order to provide an adequate remedy.[102] Needless to say, this development is predicated on the approach that *pacta sunt servanda* and that the plaintiff's performance interest should be respected.[103]

The expansion of the protection accorded to the performance interest is also reflected in the rules relating to non-economic losses. Traditionally, recovery of damages for such losses, resulting from breach of contract, has not been allowed. But this rule is becoming the subject of ever-increasing exceptions.[104]

There are parallel developments in American law under which the requirement of certainty has traditionally greatly curtailed the prospects of recovering damages for lost profits. However, the modern tendency in American law is to allow greater flexibility and wider discretion to the fact finder. As a result a lesser degree of certainty will often suffice.[105]

In addition, a broad view of the performance interest will permit

[101] *Ruxley Electronics Ltd v. Forsyth* [1995] 3 W.L.R. 118, H.L., although in *Ruxley* itself it was held that rebuilding was unreasonable. See also *Radford v. de Froberville* [1977] 1 W.L.R. 1262; *Dean v. Ainley* [1987] 1 W.L.R. 1729, C.A.; *Bevan Investments Ltd v. Blackhall and Struthers (No. 2)* [1978] 2 N.Z.L.R. 97. Regarding the relevance of good faith to this issue *cf.* also Friedmann, "Good Faith and Remedies for Breach of Contract", in *Good Faith and Fault in Contract Law* (Beatson and Friedmann eds., 1995) 399 at p. 410. In addition, it was considered until very recently that an award based on the cost of repair will only be granted, if the plaintiff actually incurred the cost of repair or undertakes or intends to do so: Treitel, *op. cit. supra*, n. 99 at p. 854; Chitty, *Contracts* (27th ed., 1994), vol. 1 § 1205. But this limitation has been whittled down. Intention is still highly relevant to the reasonableness of reinstatement. But otherwise the successful plaintiff is free to use the damages awarded to him as he pleases: *Ruxley Electronics Ltd*, *supra*, at p. 126 (*per* Lord Jauncey of Tullichettle); *Darlington Borough Council v. Wiltshier Northern Ltd* [1995] 1 W.L.R. 68, at p. 80 (*per* Steyn L.J.).

[102] *Ruxley Electronics Ltd v. Forsyth*, *supra*, n. 101 (see in particular the speech of Lord Mustill at pp. 126–128).

[103] *ibid.* at p. 127.

[104] *Jarvis v. Swans Tours Ltd* [1973] Q.B. 233; *Ruxley Electronics Ltd*, *supra*, n. 101 at pp. 139–140 (*per* Lord Lloyd of Berwick). See also Treitel, *op. cit. supra.*, n. 99 at pp. 892 *et seq.*

[105] *Restatement 2d*, *Contracts*, comments (a) and (b) to §352. See also Macaulay, *supra*, n. 2 at pp. 264–265. It seems that English law never had a specific contract rule on "certainty", though the plaintiff is obviously required to prove his loss in accordance with the rules of evidence. In addition, in American law punitive or exemplary damages for breach of contract are sometimes available. See *supra*, n. 24.

recovery of its substitute, as for example where the defendant contracts to sell a house to the plaintiff, but in breach of the contract sells it to a third party. The plaintiff may be entitled to recover in restitution the price paid to the defendant by the third party.[106]

The move towards expanding the protection granted to the performance interest has on occasion been checked[107] but the general trend is clear, and it is obviously not in line with the *Reliance Interest* article.

Reliance. The idea of reliance constitutes the very core of Fuller and Perdue's article. However, in assessing their influence on substantive law, it should be pointed out that they did not invent it.[108] For example, reliance has always been a crucial element of estoppel, which is based upon a statement made by one person inducing the other to alter his position (such a change of position may, of course, be termed "reliance").[109] Indeed, the revolutionary §90 of the *Restatement, Contracts*, which preceded Fuller and Perdue's article, is based upon an extension of this idea to promises (hence "promissory estoppel").[110] What Fuller and Perdue did was to make "reliance" the standard term describing change of position or induced action in the contractual context. Whether their article led, in problematic situations, to the award of moderate reliance damages instead of full performance (or expectation) damages is extremely doubtful.

Reliance damages may be appropriate where no contract has been concluded. This type of situation is governed in American law by §90 of the *Restatement*.[111] The wordings of §90 still maintain the old terminology. It is entitled "Promises Reasonably Inducing Action or Forbearance". Under the new terminology it should have been something like "Promises Reasonably Inducing Reliance". The term does, however, figure prominently in the comments.[112]

§90, which may be regarded as dealing with "incomplete contracts", clearly includes situations which call for "moderate recov-

[106] *Supra*, n. 19 and accompanying text. On the extension of the right to the substitute to other situations see *supra*, n. 20 and accompanying text.

[107] *Surrey County Council*, *supra* n. 22, which denied restitution of profits gained by breach of contract. The protection granted to the performance interest is, of course, even broader in jurisdictions that recognise the right of the injured party to recover such profits.

[108] *Supra*, n. 9.

[109] *Cf.* Treitel, *Law of Contract* (9th ed., 1995) p. 105 (discussing the requirement of "reliance" in the context of the equitable doctrine of waiver).

[110] This article was staunchly defended by Williston, who was bitterly attacked in the *Reliance Interest* article. On the role of Williston and on the way his position was depicted by Grant Gilmore see Linzer, *supra*, n. 71 at pp. 221–222, and Rakoff, *supra*, n. 8 at p. 207.

[111] Obviously, liability in torts and restitution may be imposed in the pre-contractual stage. On pre-contractual duties and liabilities in English law see Cohen, "Pre-Contractual Duties and Good Faith" in *Good Faith and Fault in Contract Law* (Beatson and Friedmann eds, 1995), p. 25.

[112] As already indicated, in the *Restatement (1st)* "reliance" is not mentioned in the illustrations to §90 (there were no comments to this article).

ery".[113] Fuller and Perdue disapproved the wording of the original §90 on the ground that it referred merely to the possibility of enforcement. The *Restatement 2d, Contracts* added to this section the words that the remedy may be limited as justice requires. This addition can be attributed at least in part to the *Reliance Interest* article. We have, however, noticed that this possibility might have already been embodied in the requirement that enforcement is granted only to avoid injustice, so that a more modest award could be appropriate, if it suffices to avoid injustice.[114] Under English law liability for breach of duty in the pre-contractual stage is ordinarily in tort. It does not ordinarily include damages for loss of the performance interest which has not yet been acquired.[115] But this result is reached independently and is unrelated to the theories of the *Reliance Interest* article.

In the contractual context there arises another problem when attempting to appraise the impact of the *Reliance Interest* article. The term "reliance" is commonly used, both in the *Restatement 2d, Contracts* and in court decisions. Yet, it is often used in a sense which materially differs from that ascribed to it by Fuller and Perdue, at least in the first, theoretical, part of their article.

An examination of §351(3) of the *Restatement 2d, Contracts* will suffice in order to demonstrate the problem of the *Reliance Interest* theory and its relation to substantive law. §351(3) provides that a court may limit damages "by excluding recovery for loss of profits, by allowing recovery only for loss incurred in reliance, . . . if . . . justice so requires in order to avoid disproportionate compensation". In the past courts had on occasion resorted to indirect techniques, such as the requirement of foreseeability, in order to avoid disproportionate compensation. §351(3) expressly recognises the court's power to exclude recovery for loss of profits and specifically refers to reliance loss as a possible limitation. English law does not adopt this position.[116] It is not even clear to what extent §351(3) reflects American substantive law, in view of its rather meagre support from court decisions.[117] In addition, any assumption that §351(3) presents Fuller and Perdue's theory in practice is refuted by the illustrations to this provision.[118]

Illustration 17 deals with a trucker who fails to deliver a machine

[113] It has, however, been suggested that even in cases coming within §90 there is room to award expectation damages: Slawson, "The Role of Reliance in Contract Damages" (1990) 76 Cornell L. Rev. 197. See also Yorio and Thel, "The Promissory Basis of Section 90"(1991) 101 Yale L.J. 111 who conclude that in cases decided under s.90, expectation damages are routinely awarded.

[114] See *supra*, n. 71.

[115] See *supra*, text to nn. 66 *et seq.* and *East v. Maurer*, *supra*, n. 44. *Cf.* also *Walford v. Miles* [1992] 2 A.C. 128 and Cohen, *supra*, n. 111 at pp. 48 *et seq.*

[116] Treitel, *Remedies for Breach of Contract* (1988), pp. 177–178.

[117] *Supra*, text after n. 91.

[118] Illustrations 17–20 to §351.

on time because his truck breaks down. Although he is aware that without the machine the plaintiff's factory cannot open, the court may exclude recovery for loss of profits. In Illustration 18 the liability of a dealer who delays the supply of a lighting attachment is similarly limited. In that case the attachment is needed to enable the plaintiff to use a tractor at night on his farm. Illustration 19 is based on *Sullivan v. O'Connor*,[119] and it concludes that recovery is not to include losses resulting from the failure of the plastic surgery to improve the plaintiff's appearance.

§351(3) speaks of limiting recovery to "reliance losses" and so does the comment to this provision (comment *f*). It is, however, clear that the limitation, which is basically an exclusion of profits which performance would have yielded, has little to do with the concept of "reliance interest" as developed by Fuller and Perdue, at least in the first part of their article. Fuller and Perdue's reliance includes "loss of opportunity" and it seems clear that in Illustrations 17 and 18, and perhaps also in Illustration 19, the concept would encompass the whole performance interest. Thus, in Illustration 17 the plaintiff must surely have had ample opportunities to contract with other truckers who would have delivered the machine without delay. An award based upon Fuller and Perdue's reliance interest should, therefore, include loss of profits. The conclusion in Illustration 18 (delay in delivering a lighting attachment) is similar.[120]

The position is less clear in Illustration 19 (plastic surgery). No doubt the plaintiff could have contracted with another plastic surgeon. Whether such an alternative contract (the "lost opportunity") would have yielded a better result is not clear.[121] If this is the case, then the loss resulting from the failure to improve the plaintiff's appearance is within Fuller and Perdue's reliance interest. An intricate problem arises if it was unlikely that any other surgeon would have been able to improve the plaintiff's appearance, yet it transpires that in the alternative contract, with the other surgeon, the plaintiff would have received an absolute guarantee that the operation would bring the desired result. How is the value of the lost opportunity to be appraised? Is the value of the alternative contract to be calculated according to the performance (expectation) interest or according to some other measure? As indicated, the root of this problem lies in the circular reasoning of the "lost opportunity" theory.[122]

[119] *Supra*, n. 92 and accompanying text.

[120] In this illustration it is assumed that the farmer cannot obtain a substitute lighting attachment during the delay. There is, however, no reason to assume that at the time when the contract with the dealer was made, there were no other dealers from whom the plaintiff could have similarly ordered such an attachment.

[121] See also *supra*, nn. 60 and 92 and accompanying text.

[122] *Supra*, text to n. 54.

In any event, it is apparent that in none of the above illustrations does the *Restatement* deem it necessary to take loss of opportunity into account. The position of the case law is, generally, similar.[123] This is typical. The *terms* introduced by Fuller and Perdue became part of the legal language and are now the standard terms. The position is, however, completely different with regard to the *substance*. Here we find that the meaning of "reliance" is much closer to that expressed by terms that were in use before Fuller and Perdue such as "losses", "actual losses" than to the concept developed in *The Reliance Interest*.

Conclusion

There is a great discrepancy between *The Reliance Interest*'s intellectual appeal and its effect on substantive law. The article made a deep impact on academic thinking, upon the language and discourse of contracts and led to the adoption of new terminology, which in the case of "expectation" was an unhappy development. Its effect on substantive law is at best secondary. The attack upon the performance interest goes against the grain. This interest constitutes the very core of contract law. Its ample protection is likely to be maintained and possibly expanded as long as the essence of contract law as we know it remains.

The analysis of "reliance" suffers from the dichotomy between two of the article's major themes. The one presents "reliance" as the very ground and justification for protecting the performance interest. For this purpose "reliance" must be broadly defined. It includes lost opportunities and, as a practical matter, is almost identified with the performance (or expectation) interest. The other theme is that reliance can serve to enable partial recovery where the allowance of full performance interest is unjustified. There is, of course, a fundamental conflict between these two themes, which the substantive law cannot be expected to resolve. Consequently, where recovery is confined to losses or expenditure, the award may well be described as reliance. But its content is unlikely to correspond to the meaning attached to this concept by Fuller and Perdue. It will in all probability be surprisingly similar to concepts which were well known to contract law before Fuller and Perdue, such as expenditure in performance or loss sustained (as distinguished from loss of profits).

Daniel Friedmann.*

---

[123] Kelly, *supra*, n. 75 at p. 1771 states: "Courts seeking to apply the reliance interest frequently simply add up the expenses and stop . . ."

* Dean, School of Law, College of Management; Professor of Law, Tel-Aviv University. I am very much indebted to Peter Schlechtriem, Richard Epstein, Todd Rakoff, Jack Beatson and Francis Reynolds for comments and suggestions.