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LEGAL REMEDIES FOR BREACH OF CONTRACT

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The woods are lovely, dark and deep.
But I have promises to keep,
And miles to go before I sleep,
And miles to go before I sleep.
—Robert Frost

This is an article about the remedies that our legal system provides when men do not keep their promises. It sets out the principal options that were available as those remedies developed, describes the choices that were made, and suggests some of the factors that influenced those choices. It will be seen that there were seven critical choices, and that from these the reader who has the patience to work through the analysis can deduce the bulk of the law of contract remedies.

I. First Choice: Compulsion or Relief?

Why do men keep their promises? Surely for reasons as varied and complex as men and promises themselves. Sometimes, like the father who promises to take his son to the ball game, they do so because they "want" to. At other times, like Frost's traveller on a snowy evening, they do so because they "have" to—because they feel themselves under some compulsion.[1] Surprisingly, although it might be supposed that at least one of the objectives of any system of legal remedies for breach of contract would be to compel promisors to keep their promises, our own system nevertheless purports to reject such compulsion as a goal.

If a society were seriously concerned with compelling men to keep their promises, it might be expected to treat a breach of contract as a crime and to punish defaulting promisors. Ours has not done so, and in this we are representa-

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1. For a discussion of "ethical," "social" and "jural" compulsions to perform promises, *see* Wigmore, *The Scope of the Contract Concept*, 43 Colum. L. Rev. 569, 569-70 (1943). *See also* Farnsworth, *The Past of Promise: An Historical Introduction to Contract*, 69 Colum. L. Rev. 576, 604-06 (1969).

tive of mankind as a whole.[2] Even in the communist countries, where the contracts of state enterprises are designed to carry out an economic plan in which there is the plainest public interest, breach of such a contract is not a crime. And this is said to be true of Communist China too, although performance of such contracts has there been declared to be a "political task" and party control over the individual is used to assure it.[3]

If a society were seriously concerned with the compulsion of promisors, it might at least be expected to impose civil penalties for breach of contract if it chose not to impose criminal ones. The state, rather than exact the penalty itself, might simply allow the promisee to claim a sum of money designed to punish the defaulting promisor. The communist countries do just this in enforcing contracts between state enterprises under an economic plan, by assessing a fine against the defaulting promisor, payable to the injured promisee, as a "form of social criticism."[4] In contrast, courts in this country, as in most of the rest of the world, expressly reject the notion that remedies for breach of contract have punishment as a goal, and with rare exceptions, refuse to grant "punitive damages" for breach of contract.[5] In so refusing they confidently claim to be blind to fault, and they purport not to distinguish between aggravated and innocent breach.[6] So Holmes said, "If a contract is broken the measure of damages generally is the same, whatever the cause of the breach."[7] The skeptical reader may well ask whether even men of judicial temperament are immune from the temptation to depart from a rule so oblivious of blame[8] and, indeed, some excep-

2. Criminal penalties are, however, available for some abuses of the bargaining process itself. Thus the MODEL PENAL CODE § 223.3(a) (P.O.D. 1962) defines the crime of theft to include deception by creation of a false impression as to "intention or other state of mind," but it specifically provides that "deception as to a person's intention to perform a promise shall not be inferred from the fact alone that he did not subsequently perform the promise."

3. Hsiao, *The Role of Economic Contracts in Communist China*, 53 CALIF. L. REV. 1029, 1049 (1965).

4. Grossfeld, *Money Sanctions for Breach of Contract in a Communist Economy*, 72 YALE L.J. 1326, 1332 n.41 (1963). For other discussions of the role of such contracts, *see* J. HAZARD, COMMUNISTS AND THEIR LAW ch. 13 (1969); Hsiao, *supra* note 3; Kiralfy, *A New Civil Code of the R.S.F.S.R.: A Western View*, 15 INT'L & COMP. L.Q. 1116 (1966). Grossfeld discusses the shift in East German law from a system of fines added on to compensatory damages to one of fines in lieu, at least in part, of damages, to prevent the temptation to induce breach. Grossfeld, *supra* at 1340-41. Penalties under the Comecon General Conditions, adopted for use in foreign trade by the Council for Mutual Economic Assistance, are discussed in Hoya, *The Comecon General Conditions—A Socialist Unification of International Trade Law*, 70 COLUM. L. REV. 253, 287-97 (1970). On the factors that determine whether the aggrieved party will pursue these remedies, *see* Loeber, *Plan and Contract Performance in Soviet Society*, in LAW IN THE SOVIET SOCIETY 128, 169-72 (W. LaFave ed. 1965).

5. Simpson, *Punitive Damages for Breach of Contract*, 20 OHIO ST. L.J. 284 (1959). A leading case is Addis v. Gramophone Co., [1909] A.C. 488. A leading exception is Welborn v. Dixon, 70 S.C. 108, 49 S.E. 232 (1904).

6. The term "innocent breach" should not be confused with "excusable nonperformance," which involves no breach at all. Instances of "subjective impossibility," which is not an excuse for nonperformance, are typical examples of "innocent breach." *See* RESTATEMENT OF THE LAW OF CONTRACTS § 455 & Illustrations (1933) [hereinafter cited as RESTATEMENT].

7. Globe Refining Co. v. Landa Cotton Oil Co., 190 U.S. 540, 544 (1903).

8. *See* Lagerloef Trading Co. v. American Paper Products Co., 291 F.2d 947, 956

tions to the rule will be suggested in the pages that follow.[9] In its essential design, however, our system of remedies for breach of contract is one of strict liability and not of liability based on fault,[10] and this would be a strange design indeed if it were a system directed at the compulsion of promisors.

Our system, then, is not directed at *compulsion* of *promisors* to *prevent* breach; rather, it is aimed at *relief* to *promisees* to *redress* breach. It is not much concerned with the question suggested by Frost's lines: How can men be made to keep their promises? It is instead preoccupied with a different question: How can men be encouraged to deal with those who make promises? Perhaps it is more seemly for a system of free enterprise to promote the use of contract by encouraging promisees to rely on the promises of others, rather than by compelling promisors to perform their promises out of fear that the law will punish their breaches. In any event, this at least adds to the celebrated freedom to make contracts, a considerable freedom to break them as well.

II. Second Choice: Restitution, Reliance, or Expectation?

How can men be encouraged to deal with those who make promises? The answer given by our legal system is: By protecting their expectations in the event of breach. The principal objective of the system, once breach has occurred, is to put the promisee in the position in which he would have been had the promise been performed, *i.e.*, had there been no breach.[11] This is accomplished by

(7th Cir. 1923), in which the court said, "Repudiators of fair and solemn and binding promises are commercial sinners." But our system of damages for breach of contract ordinarily imposes no penalty for this sort of sin. This is not to say that there are no areas of contract law in which account is taken of the character of the breach. There is, for example, a substantial body of authority that makes distinctions based on the character of the breach in determining whether to allow a party *in default* to recover for what he has performed before default. In one seminal case the court said: "Nothing can be more unreasonable than that a man, who deliberately and wantonly, violates an engagement, should be permitted to seek in a court of justice an indemnity from the consequences of his voluntary act. . . . Wherever there is a reasonable excuse, however, the law allows a recovery." Stark v. Parker, 19 Mass. (2 Pick.) 267, 273 (1824), *discussed in* Lee, *The Plaintiff in Default*, 19 Vand L. Rev. 1023, 1028 (1966). Cases that take account of the character of the breach in determining whether performance has been "substantial" afford another example. *E.g.*, Jacob and Youngs, Inc. v. Kent, 230 N.Y. 239, 244, 129 N.E. 889, 891 (1921) ("The transgressor whose default is unintentional and trivial may hope for mercy if he will offer atonement for his wrong").

9. *See* the discussion of *Flureau v. Thornhill*, text accompanying notes 13-16 *infra*; of the choice between cost and market price, text accompanying notes 98-117 *infra*; of recovery based on reliance, text accompanying note 133 *infra*; of recovery based on market price, text accompanying note 189 *infra*; of unforeseeable loss, text accompanying note 274 *infra*; and of uncertain loss, text accompanying note 301 *infra*.

10. Grossfeld points out that in East German law, liability for breach is based primarily on the "fault principle" rather than on strict liability so that the promisor is not liable at all for a breach occasioned by circumstances that the promisor "could not avoid." Grossfeld, *supra* note 4, at 1332-35. Contract liability is therefore more narrowly confined than in most legal systems including our own, and this narrows the applicability of the system of fines for the most part to cases of "fault."

11. The Uniform Commercial Code § 1-106(1) [hereinafter cited as UCC] provides that Code remedies "shall be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed." Of course a legal system that falls as far short as does ours of recognizing the costs of litigation when awarding relief may, for that reason, fail to attain that goal in practice. This is not, however, a problem peculiar to contracts.

giving the promisee relief based on the disappointment in his expectation, as measured by the net gain that he would have enjoyed had the promise been performed, or, as it is often said, by giving him the "benefit of the bargain." Fuller and Perdue described the interest that is protected as the promisee's "expectation" interest, and called it "a queer kind of 'compensation,'" in that it gives the promisee something he never had; they found it justifiable, however, as a means of encouraging and protecting reliance on promises.[12]

There are, of course, alternative interests of the promisee that the law might have singled out as paramount. It might have selected the promisee's "restitution" interest, as measured by the gain that the defaulting promisor made at the promisee's expense. The objective under this theory would be to put the *promisor* back in the position in which he would have been had the promise not been made. Or the law might have chosen the promisee's "reliance" interest, as measured by the loss he sustained as a result of his reliance on the promisor's promise. The objective here would be to put the *promisee* back in the position in which he would have been had the promise not been made.

In *Flureau v. Thornhill*,[13] decided in 1776, the court did in fact choose to protect the promisee's reliance interest. That case announced the rule that recovery against a vendor who promised to convey land, but is unable without any bad faith to give a good title, is limited to the expense incurred by the purchaser in reliance on the promise, including any down payment.[14] As DeGrey, C. J., stated, "I do not think that the purchaser can be entitled to any damages for the fancied goodness of the bargain, which he supposes he has lost."[15] The rule attempts to protect only the reliance interest by putting the promisee in the position in which he would have been had the promise not been made, rather than to protect the expectation interest by putting him in the position in which he would have been had the promise been performed. But although the rule has persisted in England as to contracts for the sale of land and has found its way into the law of a number of states, the tendency even in these jurisdictions has been to restrict its application.[16] In spite, then, of a few exceptions, some of which will be discussed later, where our law of remedies recognizes the alterna-

12. Fuller & Perdue, *The Reliance Interest in Contract Damages: 1*, 46 YALE L.J. 52, 53 (1936). *See also* Farnsworth, *supra* note 1, at 593-97.

13. 2 Bl. W. 1078, 96 Eng. Rep. 635 (K.B. 1776).

14. Since it turns on good faith, the rule introduces an element of "fault" not usually found in contract law. *See* note 8 *supra*. For a discussion of the rule, and its checkered career, *see* 5 A. CORBIN, CONTRACTS § 1097 (2d ed. 1963) [hereinafter cited as CORBIN]; C. MCCORMICK, HANDBOOK ON THE LAW OF DAMAGES § 178 (1935) [hereinafter cited as MCCORMICK]. The rule has been defended on the ground that the difficulty of establishing the market value of land makes the evaluation of the expectation interest too uncertain and on the ground that allowing recovery of the expectation would be a hardship on the vendor because of the risks inherent in the usual practice of making contracts to sell land without a preliminary title search. *See* Fuller & Perdue, *The Reliance Interest in Contract Damages: 2*, 46 YALE L.J. 373, 377 (1936).

15. 2 Bl. W. at 1078, 96 Eng. Rep. at 635. *See also* the mention of Ames' view that in the early development of assumpsit, damages were based on the value of the consideration given, in Farnsworth, *supra* note 1, at 595 n.77.

16. For the history of the rule in the United States, *see* 5 CORBIN § 1098; MCCORMICK §§ 179-83.

tive restitution or reliance interest upon breach of contract, the dominant theme is one of relief based on the promisee's expectation interests.

The use of the expectation interest for measuring recovery leads to results that may fall far short of compulsion. This may be seen from the following illustration:

> *Illustration 1.* Manufacturer contracts to sell goods for $100,000 to Jobber, who expects to resell them to dealers at a profit. For financial reasons, Manufacturer decides that it will be to his advantage to discontinue manufacture of the line of goods and fails to deliver to Jobber, who is unable to obtain such goods elsewhere. Jobber sues Manufacturer for breach of contract. The evidence shows that because of a drop in the market on which Jobber sells, he would have realized only $101,000 on resale of the goods, which happens to be exactly equal to the cost, $100,000, of the goods, plus the expenses, $1,000, that he would have incurred in reselling them.

Had there been no breach, Jobber would have had to spend $101,000 to gain $101,000; consequently, he requires no relief to put him in the position in which he would have been had the contract been fully performed. Manufacturer is liable for only nominal damages, trivial in amount, as the result of his decision not to perform.[17] Clearly there is no compulsion here.

There may, of course, be circumstances in which the law's use of the expectation measure will afford some compulsion for a promisor to perform his promise. He may well find it cheaper to perform than to give relief to the promisee for his disappointed expectation. And the mere possibility of a controversy that may lead to an adverse decision in court may reenforce the other compulsions that society exerts apart from law.[18] The extent to which the expectation measure does, in fact, operate as a sanction to compel performance is a matter worthy of study.[19] The point here is only that it is not designed to achieve that end.

III. Third Choice: Specific or Substitutional Relief?

The relief available to the promisee is of two main kinds.[20] It is said to be "specific" when it is intended to secure for the promisee the very benefit that he

17. Nominal damages are given since in principle a breach of contract always gives rise to a right of action; costs are not always awarded with the nominal damages, however, and in some jurisdictions a failure to award nominal damages is not grounds for reversal. Even if the injured party is awarded costs along with nominal damages, this will fall far short of reimbursing him for the actual expenses of litigation. *See* 5 Corbin § 1001.

18. There is also the possibility that such compulsions will tend to dissuade the promisee from seeking to hold the promisor to his promise, perhaps resulting in compromise. On the strong tendencies along these lines in Japan, *see* T. Kawashima, *Dispute Resolution in Contemporary Japan*, in Law In Japan: The Legal Orber in a Changing Society 41 (A. von Mehren ed. 1963). *See also* Lubman, *Mao and Mediation: Politics and Dispute Resolution in Communist China*, 55 Calif. L. Rev. 1284 (1967); Cohen, *Chinese Mediation on the Eve of Modernization*, 54 Calif. L. Rev. 1201 (1966).

19. *See* Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 Am. Sociological Rev. 55 (1963).

20. Restatement § 326 lists restitution as a third kind of relief. It is, however, better

was promised, as where the court confers the promised benefit on the injured party or orders the defaulting promisor to do so. It is said to be "substitutional" when it is intended to provide him with something in substitution for that benefit, as where the court awards the injured party money damages.[21]

Although damages will, in some cases, permit the injured party to arrange an adequate substitute for the expected benefit, specific relief is clearly the form better suited to the objective of putting the promisee in the position in which he would have been had the promise been performed. Of course the passage of time may reduce the effectiveness even of specific relief. The benefit will at best usually be delayed since contract remedies are ordinarily not available until after breach has occurred.[22] And there are some situations in which specific relief is simply not possible at all. For example, the promise may have been one to deliver particular goods which turn out to be defective, or to have been destroyed, or to have been sold to a third person. But there remain many instances in which specific relief will be both timely and feasible. They can be put into two broad categories.

In one category of cases, specific relief does not require the cooperation of the defaulting promisor. If the promise is to deliver goods, an officer of the court may seize and deliver them; if it is to convey land, he may execute a binding conveyance; if it is to pay money, he may seize and sell enough of the promisor's assets to yield the required sum. In this category the practical impediments to specific relief are at a minimum. In the other category of cases, however, specific relief does require the cooperation of the promisor. Consider, for example, a promise to act in a play, to paint a house, or to build a building. To assure specific relief in each of these cases some form of coercion may be needed, so that the practical impediments are substantial.

The civil law system, *i.e.*, those descended from Roman law, have by and

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to view restitution as an interest to be protected (where the attempt is to put the promisor back in the position in which he would have been had the promise not been made), rather than as a kind of relief. As § 326 itself points out, restitution may be either "specific" or "substitutional."

21. Substitutional redress need not be limited to money, but may be in kind. Isaac Schapera tells of a case among the Tswana in which a man who broke his promise to deliver a cow to another was obliged to deliver four cows, one in substitution for the cow he should have given and three in substitution for its offspring. Schapera, *Contract in Tswana Case Law*, 9 J. AFRICAN L. 142, 148 (1965). Charles Wright notes the incidence of this in everyday dealing—"If I lose the ski poles I have borrowed from a friend, I buy a new pair and return them to him"—and suggests that legal sanctions of this sort might be considered. Wright, *The Law of Remedies as a Social Institution*, 18 U. DET. L.J. 376, 378 (1955). In a society with a market economy, however, the tendency is to assume that the injured party can procure a substitute himself and need only be compensated for the expense involved. In French law, for example, if the promisor fails to perform his duty to do work, as where a landlord fails to repair the leased premises, the court may authorize the promisee to have it done at the promisor's expense. P. HERZOG, CIVIL PROCEDURE IN FRANCE 557 (1967). *Cf.* the buyer's remedy of "cover" under UCC 2-712, discussed in text accompanying notes 166-73 *infra*.

22. In the exceptional case where a party repudiates his obligation in advance of the time for performance, specific relief might be given without delay. And where a declaratory judgment is granted before the time for performance, it at least reinforces the extra-legal compulsions to perform, although it adds no legal compulsion.

large proceeded on the premise that specific redress should be ordered whenever possible, not only for cases in the first category, but even for those in the second category as well, unless the disadvantages of the remedy outweigh its advantages. As Dawson has said of the German law,

> The main reservations are for cases where specific relief is impossible, would involve disproportionate cost, would introduce compulsion into close personal relationships or compel the expression of special forms of artistic or intellectual creativity. Presumably German courts, like French courts and our own, would not affirmatively order painters to paint pictures or singers to sing.[23]

The logic of the civil law is reenforced by practical considerations in communist countries that lack markets on which aggrieved parties can arrange substitute transactions. The task of manufacture imposed on a state enterprise by a government plan, for example, can only be accomplished if the enterprise receives the specific raw materials that it has been promised for production; money damages are not an adequate substitute.[24]

The common law countries escape both the civil law's doctrinal logic and communism's practical need for compulsion. The early common law courts did know specific relief, for many of the first suits after the Norman Conquest were proprietary in nature, designed to regain something of which the plaintiff had been deprived.[25] Even the action of debt was of this character, since it was based on the notion of an unjust detention of something belonging to the plaintiff.[26] But it became the practice in these actions to allow money damages for the detention in addition to specific relief, and with the development of new forms of action, such as assumpsit, that were in no way proprietary, subsitutional relief became the usual form.

The typical judgment at common law declared that the plaintiff recover from the defendant a sum of money, which in effect imposed on him a new obligation as redress for the breach of the old. The new obligation required no cooperation on his part for its enforcement since, if the sum was not paid, a writ

23. Dawson, *Specific Performance in France and Germany*, 57 MICH. L. REV. 495, 530 (1959). In France, however, a distinction is made between promises "to give," and those "to do or not to do." *Id.* at 506-25. As to the latter, the system for enforcement of court orders of specific performance, known as the *astreinte*, is of questionable effectiveness. "An outside observer will be excused, I hope, for describing such a principle [of allowing specific performance] as almost wholly meaningless where the *astreinte* is the only means employed for its realization." *Id.* at 524-25. Another writer, describing specific performance and the *astreinte* in French law, reports that since a 1959 decision of the *Cour de Cassation*, "French law professions no longer share this scepticism." P. HERZOG, *supra* note 21, at 563.

24. *See* Grossfeld, *supra* note 4, at 1330-31. On the impact of "economic revisionism," *see* M. GAMARNIKOV, ECONOMIC REFORMS IN EASTERN EUROPE (1968), where the author describes how "communist economics began to emerge from the era of absolute scarcity and strictly controlled production and distribution into a stage of a limited buyer's market," and points out that "the impact of the Western prosperity on economic thinking in the Soviet bloc can be seen in various attempts to incorporate the principles of a market economy into the framework of central planning." *Id.* at 12, 19.

25. *See* Washington, *Damages in Contract at Common Law*, 47 L.Q. REV. 345 (1931).

26. *See* Farnsworth, *supra* note 1, at 586-87.

of execution would issue empowering the sheriff to seize and sell so much of the defendant's property as was required to pay the plaintiff. The proprietary actions remained, so that there were a few instances where relief at common law was specific; for example, in an action by a buyer for replevin of goods sold to him but not delivered, the sheriff might first seize them from the seller and turn them over to the buyer,[27] and the judgment would then declare that the buyer was entitled to them. And, of course, where the claim was to a sum of money that the defendant had promised to pay, the effect, as in the original action for debt, was to give the promisee specific relief; for example, in an action by the seller for the price of goods delivered but not paid for, judgment would be given against the buyer for the full amount of the price.[28] But these instances were the exception rather than the rule, and even where the common law courts granted specific redress, they were unwilling to exert pressure directly on the defendant to compel him to perform. The judgment itself was seen as a mere declaration of rights as between the parties, and the process for its execution was directed not at the defendant but at the sheriff, ordering him to put the plaintiff in possession of real or personal property or to seize the defendant's property and sell such of it as was necessary to satisfy a money judgment.[29]

The enforcement of promises in equity developed along very different lines. Prior to the development of assumpsit by the common law courts in the sixteenth century, most of the cases brought before the chancellor were based on promises that would not have been enforceable at common law, and the question was whether they would nevertheless be enforced in equity. After the development of assumpsit, equity accepted the test for enforcement that had been developed by the rival common law courts, and refused to enforce simple promises made without "consideration." To this extent its jurisdiction in contract became concurrent with that of the common law courts, and its concern shifted from the enforceability of the promise to the nature of its enforcement.[30]

Under the influence of the canon law (for the early chancellors were usually clerics), decrees in equity came to take the form of a personal command to the defendant to do or not to do something. His cooperation was assumed, and if he disobeyed he could be punished not only for criminal contempt, at the instance of the court, but also for civil contempt, at the instance of the plaintiff. This put into the plaintiffs hands the extreme sanction of imprisonment, which might be supplemented by fines payable to the plaintiff and sequestration of the

27. Since replevin was generally available only to the owner of property, the rationale was that the ownership of the goods in the seller's possession had passed to the buyer. *See* UNIFORM SALES ACT § 66 (now replaced by the UCC).

28. On the enforcement in equity of decrees for payment of money, *see* W. WALSH, A TREATISE ON EQUITY 62-63 (1930).

29. C.A. HUSTON, THE ENFORCEMENT OF DECREES IN EQUITY 7 (1915). On the common law's use of imprisonment for debt, *see* 8 HOLDSWORTH, A HISTORY OF ENGLISH LAW 231-33 (1926).

30. H. MCCLINTOCK, HANDBOOK OF THE PRINCIPLES OF EQUITY 125-27 (2d ed. 1948); W. WALSH, *supra* note 28.

defendant's goods.[31] So it was said that equity acted *in personam*, against the person of the defendant, while the law acted *in rem*, against his property.[32] But it did not follow that the chancellor stood ready to order every defaulting promisor to perform his promise. Equitable relief was confined to special cases in light of both practical and historical limitations.

The practical limitations grew out of the problems inherent in coercion. Our courts, like those of civil law countries, will not undertake to coerce a performance that is personal in nature—to compel an artist to paint a picture or a singer to sing a song. (They have, to be sure, been ingenious in framing orders enjoining contracted parties from acting inconsistently with their promises as a substitute for orders directing them to perform them—the court that will not order the singer to sing may enjoin him from singing elsewhere.)[33] Our courts have also been reluctant to order specific performance where difficulties of supervision or enforcement are foreseen, *e.g.*, to order a building contractor specifically to perform his contract to repair a house. It has been suggested that in their origins these ideas carried a load of snobbery, expressed in distaste for menial tasks—'how can a Master judge of repairs in husbandry?' "[34] Today they are more often justified as a means of avoiding conflict and unfairness where no clear standards can be framed in advance. The practical exigencies of drafting decrees to guide future conduct under threat of contempt have also moved courts to require that contract terms be expressed with somewhat greater certainty if specific performance is to be granted than if damages are to be awarded.[35] But these practical limitations are on the whole far less significant than the historical ones.

31. The development of these supplementary sanctions is traced in C.A. HUSTON, *supra* note 29, at 76-83; W. WALSH, *supra* note 28, at 47-48. Huston notes the measures required "to coerce obedience from the stubborn seventeenth-century Englishman. Thus in 1598, after one Walter had been already subjected in vain to close imprisonment for some time, the court ordered him to perform within a fortnight 'which if he shall not do . . . then his Lordship mindeth without further delay not only to shut the defendant close prisoner but also to lay as many irons on him as he may bear.'" *Id.* at 79, *citing* Clerk v. Walter, Monro 718.

32. *See generally* F. JAMES, CIVIL PROCEDURE 21-24 (1965). For a discussion of the power of equity to act *in rem*, *see* C.A. HUSTON, *supra* note 29, at 71-86; H. MCCLINTOCK, *supra* note 30, at 94-96; W. WALSH, *supra* note 28, at 45-50. Declaratory relief, in which the court states the rights of the parties but does nothing further to enforce them, may operate to secure performance of promises through non-jural sanctions that coerce performance. F. JAMES, *supra* at 26-31.

33. Lumley v. Wagner, 1 De G.M. & G. 618, 42 Eng. Rep. 687 (Ch. App. 1852). A more extreme example is that of a suit for specific performance of a contract to run street cars to connect with the plaintiff's trains, in which the court enjoined the defendant from operating any cars unless it performed its contract. Prospect Park & Coney Island R.R. v. Coney Island & Brooklyn R.R., 144 N.Y. 152, 39 N.E. 17 (1894).

34. Dawson, *supra* note 23, at 537, quoting from Rayner v. Stone, 2 Eden 128, 130, 28 Eng. Rep. 845, 846 (1762). Consider also the remark of Chancellor Walworth, in a suit against an opera singer for specific performance: "I am not aware that any officer of this court has that perfect knowledge of the Italian language, or possesses that exquisite sensibility in the auricular nerve which is necessary to understand, and to enjoy with a proper zest, the peculiar beauties of the Italian opera, so fascinating to the fashionable world." DeRivafinoli v. Corsetti, 4 Paige 263, 270 (N.Y. 1833). *See generally* 5A CORBIN §§ 1171-72.

35. Bethlehem Eng'r Export Co. v. Christie, 105 F.2d 933, 934 (2d Cir. 1939) (per

The most important of the historical limitations derives from the circumstance that, since the chancellor had first granted equitable relief in order to supply the deficiencies of the common law, equitable remedies were readily characterized as "extraordinary." When, during the long jurisdictional struggle between the two systems of courts, some means of accommodation were needed, an "adequacy" test was developed to prevent encroachment by the chancellor on the powers of the common law judges. Equity would stay its hand if the remedy at law was "adequate."[36] To this test was added the gloss that the money damages awarded by the common law courts were ordinarily "adequate"—a gloss encouraged by the philosophy of free enterprise, since in a market economy money ought to enable an aggrieved promisee to arrange a substitute transaction. As one writer put it:

> The law, concerning itself more and more with merchandise bought or sold for money, with things having a definite and calculable exchange value, came to conceive that the money compensation, which was an entirely adequate remedy in the common case, and in many cases the only possible one when once the wrong complained of had been committed, was [generally] the only remedy available for their use . . . .[37]

So it came to be that, in sharp contrast to the civil law approach, money damages were regarded as the norm and specific relief as the deviation, even where the law could easily have provided specific relief without any cooperation from the defaulting promisor.

Land, which the common law viewed with particular esteem, was singled out for special treatment. Each parcel, however ordinary, was considered to be "unique," and from this it followed that if a vendor defaulted on his promise to convey land, not even money would enable an injured purchaser to find a substitute. The remedy at law being in this sense "inadequate," a decree of specific performance would ordinarily issue.[38] Although the case for allowing the vendor to have specific performance when the purchaser defaulted was less com-

Learned Hand, J.: "This contract is so obscure, and, strictly taken, so incoherent, that nobody can be sure of its meaning. . . . *Arguendo*, we shall assume that these promises created a valid contract which could be enforced at law like any other; but it does not follow that equitable remedies would also be available . . . ."); Van Dyke v. Norfolk Southern R.R., 112 Va. 835, 72 S.E. 659 (1911). *But cf.* City Stores Co. v. Ammerman, 266 F. Supp. 766 (D.D.C. 1967).

36. According to Holdsworth, "It was not till the eighteenth century that it was settled that equity would only grant specific relief if damages were not an adequate remedy." 1 W. HOLDSWORTH, A HISTORY OF ENGLISH LAW 457 (7th ed. 1956).

37. C.A. HUSTON, *supra* note 29, at 74. Holmes, with some overstatement, wrote that "The duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it—and nothing else." Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 462 (1897).

38. *E.g.*, Kitchen v. Herring, 42 N.C. 190 (1851) (principle in regard to land adopted, not because it was fertile or rich in minerals, or valuable for timber, but simply because it was land—a favorite and favored subject in England, and in every country of Anglo-Saxon origin).

pelling, equity also granted him relief.[39] But no such reason applied to the contract for the sale of goods, for in a market economy it was supposed that, with rare exceptions for such "unique" items as heirlooms and objects of art, substantially similar goods were available elsewhere.[40] Some attempts have been made to liberalize this restriction. The draftsmen of the Uniform Commercial Code state in its Comments that it introduces "a new concept of what are 'unique' goods,"[41] and they assert that "where the unavailability of a market price is caused by a scarcity of goods of the type involved, a good case is normally made for specific performance under this Article."[42] But specific performance is still the exception, not the rule, and in contrast to the view held in socialist countries, it is to be justified on the basis of the peculiar needs of the aggrieved party and not the general welfare of society as a whole. Although a court, in determining the adequacy of an award of damages, may take account of such factors as the difficulty of their ascertainment (*e.g.*, under a long-term "output" or "requirements" contract[43]) and the improbability of their collection (*e.g.*, against an insolvent defendant[44]), the typical buyer of goods must still content himself with money as a subsitute for the goods in the event of breach.

A second historical limitation, or group of limitations, is premised on the notion that equitable relief is "discretionary." Since the chancellor was to act according to "conscience" (a circumstance that prompted the famous charge that his conscience might vary with the length of his foot[45]), he might withhold relief where considerations of "fairness" or "morality" dictated. Some of the most renowned of these equitable restrictions are embodied in equity's colorful maxims: "he who seeks equity must do equity";[46] "he who comes into equity

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39. *E.g.*, Hopper v. Hopper, 16 N.J. Eq. 147 (1863). For discussion of the basis of this rule, *see* 5A CORBIN § 1145.

40. *E.g.*, McCallister v. Patton, 214 Ark. 293, 215 S.W.2d 701 (1948) (specific performance denied buyer of automobile in spite of short supply following World War II). *But see* Morris v. Sparrow, 225 Ark. 1019, 287 S.W.2d 583 (1956) (specific performance granted cowboy who had been promised horse after he trained him).

41. UCC § 2-716, Comment 2, which goes on to say that

> output and requirements contracts involving a particular or peculiarly available source or market present today the typical commercial specific performance situation, as contrasted with contracts for the sale of heirlooms or priceless works of art which were usually involved in the older cases.

See, e.g., Curtice Bros. v. Catts, 72 N.J. Eq. 831, 66 A. 935 (1907) (supply of tomatoes for canning could not be replaced in time). *See also* UCC § 1-106 and note 11 *supra*.

42. UCC § 2-713, Comment 3.

43. *E.g.*, Eastern Rolling Mill Co. v. Michlovitz, 157 Md. 51, 145 A. 378 (1929).

44. *E.g.*, White Star Refining Co. v. Hansen, 251 Mich. 224, 231 N.W. 577 (1930). *But cf.* Heilman v. Union Canal Co., 37 Pa. 100 (1860) (insolvency alone not sufficient). Where the defendant is insolvent, the situation of his other creditors should not, however, be overlooked. *Cf.* UCC § 2-502 on the buyer's right to the goods on the seller's insolvency.

45. "'Tis all one, as if they should make his foot the standard for the measure we call a Chancellor's foot; what an uncertain measure this would be! One Chancellor has a long foot, another a short foot, a third an indifferent foot; 'tis the same thing in the Chancellor's conscience." SELDEN, TABLE TALK, *quoted in* Gee v. Pritchard, 2 Swanst. 402, 414, 36 Eng. Rep. 670, 679, (Ch. 1818).

46. *E.g.*, Hazzard v. Westview Golf Club, — Me. —, 217 A.2d 217, 225 (1966).

must come with clean hands";[47] and "equity aids the vigilant."[48] One of the most troublesome is the now largely discredited "mutuality of remedy" rule, under which specific performance would not be granted to the aggrieved party unless it would have heen available to the other party had the aggrieved party been the one in breach.[49] It is one of the curious inconsistencies to arise out of the dual jurisdiction of law and equity that these restrictions operated to bar only equitable relief and did not prevent the award of damages at law.[50]

The historical development of the parallel systems of law and equity may afford an adequate explanation of the reluctance of our courts to grant specific relief; it is scant justification for it. A more rational basis might be the severity of the sanctions available under the contempt power for their enforcement.[51] In any event, the current trend is clearly in favor of the extension of specific relief. The fusion of law and equity into a single court system at least facilitates a major change in this direction, and commentators have urged such a change.

> Why not, as in both French and German law, give specific performance as to any physical object that can be found and is reachable by direct execution? It is true that whenever speed is a factor and markets reasonably organized, promisees will not often ask for it . . . . But why not leave this to the promisee's choice?[52]

Still, for the present, the promisee must ordinarily be content with money damages.

The award of money to one aggrieved by a civil wrong dates back to a time when its primary purpose was to keep the peace. As one writer explained:

> The root idea of primitive law is not compensation for injury but composition for revenge. . . . With the growth of the power of the state and the consequent respect for the law which found its sanction in that power, composition gradually became compensation. The idea of penalty grew into that of reparation.[53]

Ultimately, the remedies recognized for delicts by primitive law were extended by the common law to give a remedy for breach of promise, and so the modern

47. New York Football Giants v. Los Angeles Chargers Football Club, 291 F.2d 471, 473 (5th Cir. 1961) (Giants denied injunction to prevent Charles Flowers from playing with Chargers, in violation of his contract with Giants; Giants did not have "clean hands" because they had kept contract secret so that Flowers would not be barred from playing in Sugar Bowl). *But cf.* Washington Capitols Basketball Club v. Barry, 419 F.2d 472 (9th Cir. 1969) (dispute between Washington "Caps" and San Francisco Warriors over services of Rick Barry).

48. Swiss Oil Corp. v. Fyffe, 296 Ky. 178, 186, 176 S.W.2d 398, 402 (1943).

49. For a case invoking the rule to allow specific performance, *see* Hopper v. Hopper, 16 N.J. Eq. 147 (1863). For an extensive criticism of the rule, *see* 5A CORBIN §§ 1178-1204.

50. An exception is the equitable rule against enforcement of an "unconscionable" bargain, which has been made a rule of law for contracts of sale by UCC § 2-302.

51. *See* Dawson, *supra* note 23, at 537-38.

52. Dawson, *supra* note 23, at 532. *See also* 5A CORBIN § 1136; Van Hecke, *Changing Emphases in Specific Performance*, 40 N.C. L. REV. 1 (1961).

53. C.A. HUSTON, *supra* note 29, at 39-40 (1915). This article does not deal with remedies in tort for acts amounting to breach of contract, for example, action in conversion for the seller's failure to deliver goods is not included within its scope.

contract grew out of the delictual action of assumpsit. We acknowledge this origin through the indiscriminate use of the word "damages" in describing any award of money in an action based on contract, including instances in which the award amounts to specific relief. As Pound pointed out, "we speak of recovering damages even in the case of a liquidated debt. Obviously damages are not what is really covered."[54]

With the extension of the action of assumpsit that had been achieved by the end of the sixteenth century, courts were confronted with the task of fashioning a system for the award of money to enforce the newly created rights based on promises. An initial question went to the division between judge and jury of the power to fix damages. Although the judges might have been expected to reserve this power largely to themselves, there were practical reasons to confide it in the jury.[55] The common law judges were intent on expanding their influence, and since trial by jury was seen as a means of attracting litigants who might otherwise have gone elsewhere, the popular course was to leave the assessment of damages in the jury's hands. Once this had been done, it became apparent that the courts had both to devise procedures to enable them to control the jury in order to prevent abuse of its power and to formulate principles to be used in the exercise of that control. For roughly two centuries after the development of the action of assumpsit, however, the courts were so absorbed in the procedural problems of control that they paid scant attention to the principles to be used in its exercise.[56]

Among the various procedures that were developed for the control of the jury were those by which the trial court judge ruled on the admissibility of evidence, instructed the jurors on the law, and was enabled after trial to set aside the jury's verdict and grant a new trial before another jury. It was the last of these that was the most significant. Since the trial court judge could order a new trial on the ground that the jury had disregarded his advice, *e.g.*, by awarding excessive damages, he gained some assurance, beyond that derived

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54. Pound, *Individual Interests of Substance—Promised Advantages*, 59 HARV. L. REV. 1, 3 (1945). Lord Mansfield noted in such a case,

> Although this be nominally an action for damages, and damages be nominally recovered in it; yet it is really and effectually brought for a specific performance . . . . For pecuniary damages upon a contract for the payment of a thing are, from the nature of the things, specific performance.

Robinson v. Bland, 2 Burr. 1077, 1086, 97 Eng. Rep. 717, 722 (K.B. 1760). After Slade's Case, 4 Co. Rep. 92b, 76 Eng. Rep. 1074 (K.B. 1602), when a suit to enforce a debt could be brought in assumpsit, it was natural to speak of "damages," even in such an action. *See* Farnsworth, *supra* note 1, at 597-98.

55. A simple expedient for avoiding this would have been to fashion a schedule of damages, although this would scarcely have been suitable in view of the protean quality of the wrongs comprehended by contract. A biblical example, in tort, is found in the schedule that the Lord gave Moses, as set out in *Exodus* 22:1: "If a man shall steal an ox or a sheep, and kill it, or sell it, he shall restore five oxen for an ox, and four sheep for a sheep."

56. Washington, *supra* note 25, at 346. The earliest treatise on damages is A. SAYER, THE LAW OF DAMAGES (1770). The first American work is T. SEDGWICK, A TREATISE ON THE MEASURE OF DAMAGES (1st ed. 1847).

from his prestige alone, that his instructions would be given proper weight. And from this it was only a short step to direct control over the assessment of damages by a specific instruction to the jury as to the amount to be allowed should there be recovery. The trial court judge might also grant a new trial on the ground that he had himself erred in ruling on the admissibility of evidence, including evidence as to damages, or in his charge to the jury, including his instructions as to damages. Most important, the ruling of the trial judge on a motion for a new trial was a matter of "law" which could be considered on appeal by a higher court. It was out of appeals from these rulings that the courts, toward the end of the eighteenth century, finally began to limit the body of principles that were to govern the award of damages for breach of contract.[57] To the general principle of recovery based on the promisee's expectation interest there emerged three important limitations. They guard against the possibility, suggested by the following illustration, that a crushing burden might be imposed on the promisor.

> *Illustration 2.* Supplier contracts to sell Manufacturer a replacement part for Manufacturer's broken machine for $100. Supplier fails to deliver the part and the machine remains idle. Manufacturer sues Supplier for $100,000 in damages based on the loss of anticipated profits through the use of the machine in his business over the ten-year life of the part.

Full protection of the expectation interest has been described by one commentator as "one of those generous aspirations which the law does well to put but sparingly into practice."[58]

One of the limitations that have emerged concerns the aggrieved party's behavior after breach. The calculation of the damages that are required to put him in the position in which he would have been had the promise been performed takes, as its point of departure, his situation after breach. It is often open to him to take steps to ameliorate, or at least to avoid aggravating, that situation. Should he be expected to do so even though this will redound to the benefit of the defaulting promisor by diminishing his liability? If, in Illustration 2, Manufacturer can obviate his loss of profits by purchasing a similar part in substitution for the one promised by Supplier, should he be expected to do so? Courts have commonly answered such questions in the affirmative and refused to allow the injured party to recover for loss that was "avoidable."

A second limitation relates to the extent of the risk undertaken by the party in breach. The classic, if apocryphal, case is that "where a man going to be married to an heiress, his horse having cast a shoe on the journey, employed a blacksmith to replace it, who did the work so unskillfully that the horse was lamed, and, the rider not arriving in time, the lady married another; and the

57. Washington, *Damages in Contract at Common Law II*, 48 L.Q. Rev. 90-93 (1932).
58. *Id.* at 107.

blacksmith was held liable for the loss of the marriage."[59] How far can the aggrieved party hold the other accountable for the loss of such expectations as these? In Illustration 2, even assuming that no similar part could have been obtained as a substitute, does it follow that Manufacturer can hold Supplier accountable for all of his anticipated profits over a ten-year period? To answer such questions courts developed a test of "foreseeability" as an outer limit, and refused recovery for loss that was "unforeseeable."

A third limitation goes to the adequacy of proof. Generally it is the aggrieved party who has the burden of persuasion on this point. How convincingly must he establish, for example, the position in which he would have been had the promise been performed? If Manufacturer in Illustration 2 is to recover his anticipated profits, how persuasive must be his evidence as to their amount? Through the attempts during the eighteenth century to control the jury's assessment of damages, there evolved a principle that "certainty" was required in the proof of contract damages and that there could be no recovery for loss that was "uncertain." As De Grey, C. J., said in 1774, "In contract the measure of damages is generally matter of account, and the damages given may be demonstrated to be right or wrong. But in torts a greater latitude is allowed to the jury: and the damages must be excessive and outrageous to require or warrant a new trial.[60] The operation of this requirement of "certainty" within the framework of the procedure for new trial is said to have caused the body of rules for damages to develop more rapidly in contract than in tort.[61]

The general principle as it has evolved, then, is that—subject to these three limitations—the injured party's expectation interest will be protected by subsitutional relief that will secure for him the "benefit of the bargain." The remainder of this article will consider, in turn, (a) the operation of this general principle and some of the problems that arise in calculating the amount of recovery appropriate for the protection of the injured party's expectation interest; (b) two alternatives to this general principle, namely, the alternatives of basing recovery on the injured party's restitution interest or on his reliance interest,

59. Willes, J., in British Columbia Saw Mill Co. v. Nettleship, L.R. 3 C.P. 499, 508 (1868). A similar illustration is that "where a Canon of the church, by reason of the non-delivery of a horse pursuant to agreement, was prevented from arriving at his residence in time to collect his tithes." Griffin v. Colver, 16 N.Y. 489 (1858). This is evidently taken from that of Pothier quoted in note 235 *infra*.

60. Sharpe v. Brice, 2 Black, W. 942, 943, 96 Eng. Rep. 557 (K.B. 1774). Common Pleas would not grant a new trial in tort unless the amount awarded was "monstrous and enormous . . . such as all mankind must be ready to exclaim against, at first blush." *Accord*, Beardmore v. Carrington, 2 Wils. K.B. 244, 250, 95 Eng. Rep. 790, 793 (1764). *See* Washington, *supra* note 25, at 363-66. A test of "reasonable certainty" is now said to be applied in tort cases. *See* 2 F. HARPER & F. JAMES, THE LAW OF TORTS § 25.3 (1956). But it is often less strongly phrased than is the test for contract cases. *Compare* RESTATEMENT OF THE LAW OF TORTS § 912 (1938) ("such certainty as the nature of the tort and the circumstances permit") *and* Comment *d* ("a fair degree of certainty") *with* RESTATEMENT § 331 (1) ("reasonable certainty") and Comment *a* ("a reasonable degree of certainty"). *See also* MCCORMICK, § 32. *But see* 5 CORBIN § 1028.

61. Washington, *supra* note 57, at 92.

and the situation in which these alternatives are appropriately put to use; and (c) the operation of the three principal limitations that have been placed on the principle of protecting the injured party's expectation interest with regard to loss that is "avoidable," "unforeseeable," or "uncertain."

IV. Fourth Choice: Cost to Complete or Diminution in Value?

A system of damages for breach of contract which has as its general basis the protection of expectations suffers from two handicaps. The first is that it requires a hypothesis—a hypothesis of the position in which the injured party would have found himself had both he and the party in breach performed. Some of the problems involved in this hypothesis are discussed later in connection with the requirement of foreseeability. The second handicap is that it requires an estimate—an estimate of a sum of money considered adequate to put him in that position. This estimate might be based on cost to complete, that is, the additional financial sacrifice that the injured party would have had to incur in order to obtain a substitute performance considered adequate to put him in the desired hypothetical position. Or it might be based on diminution in value, that is, on the loss of advantage to the injured party that resulted from his not being in that position.[62]

Basing the estimate on cost to complete has initial appeal, as seeming to come closer to actually assuring the injured party's expectation. This assumes, however, that a substitute performance will be generally available at some cost to put the injured party in the desired hypothetical position. Yet in many instances no substitute performance is available at any cost. The party in breach may be uniquely capable of performing his promise, *e.g.*, a promise to star in a play or to disclose a secret process. Or the delay occasioned by his failure to perform his promise may have made any performance impossible, *e.g*, a promise to perform an emergency operation or to install a fire alarm.[63] And even in those instances where an adequate substitute performance can be found, problems of valuation are not necessarily eliminated. The injured party ought to be compensated for any delay that has occurred, and cost to complete is not a suitable basis for this because no amount of money can turn the clock back. In the face of such practical difficulties in basing the estimate on cost to complete, it is not surprising that the preference in our legal system is for an estimate based on diminution in value.[64]

62. According to Bonbright "'value' . . . refers to the advantage that is expected to result from the ownership of a given object of wealth (or to the market price that this advantage will command), whereas ['cost'] refers to the sacrifice involved in acquiring this object. This distinction is clearly in our minds when we ask whether any thing, or any desirable human achievement, 'is worth what it costs.'" 1 J. Bonbright, The Valuation of Property 19 (1937).

63. Note 21 *supra* collects some examples where substitutional relief is in kind rather than in money. But such relief is practicable in only a small proportion of cases.

64. It would still be possible to fashion a rule that based the estimate on cost to complete to the extent that this was possible, and used diminution in value only where

In principle the diminution in value sought is that to the injured party himself, quite without regard to the diminution in value to anyone else, and depends on his own particular circumstances, including his personal needs and resources or of those of his enterprise. According to Bonbright, value in this sense "represents a state of mind, a favorable attitude of a particular person or group of persons."[65] Basing the estimate on diminution in value, therefore, requires the sometimes questionable assumption that this loss of advantage to the injured party can be expressed in terms of money. Still, where the injured party's expected advantage consists largely or exclusively of the realization of profit, as is the case for most commercially significant exchanges, it can be so expressed with some assurance, and our courts have been able to live with this assumption.

Two ingredients enter into this estimate of the difference between the value to the injured party of the hypothetical situation in which he would have found himself after full performance of the exchange, and his actual situation after breach. The first ingredient is the injured party's *loss on the bargain*, which he suffers because the exchange for which he originally bargained has been frustrated. It may have two components. One component is the *loss in value* to the injured party of the other party's performance, and is equal to the difference between the value to the injured party of what the other party was to have done under the contract and the value of what he in fact did. This component is always present, regardless of whether the breach is partial or total. Where the breach is total, the injured party may elect to rely on it as an excuse for not rendering the balance of his own performance; if he does so elect, a second component enters into the calculation of his *loss on the bargain*. This component is the cost that he avoided as a result of being excused. His *loss on the bargain* is then the difference obtained by subtracting this *cost avoided* from the *loss in value*.[66]

Loss on the bargain = loss in value — cost avoided

In addition to *loss on the bargain*, there may be a second ingredient, namely, *other loss* such as physical harm to the injured party's person or property and expenses incurred by him in an attempt to salvage the transaction after breach. The general measure of recovery, then, is the sum of these two ingredients of the injured party's loss.

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cost to complete could not be used. In this connection, see the discussion of cost to complete as a measure of diminution in value, at text accompanying notes 89-120 *infra*. For a case holding that the estimate is to be based on diminution in value, *see* Guardian Trust Co. v. Brothers, 59 S.W.2d 343 (Tex. Civ. App. 1933), in which, however, the court seems to have overlooked the point, made at note 89 *infra*, that cost of completion fixes the upper limit of diminution in value.

65. 1 J. Bonbright, *supra* note 62, at 67. It therefore takes into account the value of money itself to the injured party. *Id.* at 70.

66. Problems of allowing interest on the amounts in question, to take account of differences in times of performance, will be ignored here for the sake of simplicity.

Damages = *loss on the bargain* + *other loss.*[67]

Combining these two equations gives Formula A:

(A) *Damages* = *loss in value* — *cost avoided* + *other loss*

Since in most agreements one of the parties is required to pay money,[68] the estimation of *loss in value* and *cost avoided* usually poses problems only in connection with the performance of the other party, who may be required, for example, to furnish goods, land, or services in return. The party who is to furnish this latter performance will here be call the "supplier" and the one whose performance is to be the payment of money will be called the "recipient."

It is convenient to consider separately, first, cases in which the supplier is the injured party and, second, cases in which the recipient is the injured party. The reason for this is that where the supplier is the injured party and the breach consists of the recipient's failure to pay, the difficulty in determining the supplier's *loss on the bargain* lies in the determination of his *cost avoided*; his *loss in value* is already expressed in terms of money, namely, what the recipient failed to pay. The reverse is true where the recipient is the injured party and the supplier is in breach. Here, in determining the recipient's *loss on the bargain,* the difficulty lies in the component of *loss in value* sustained by the recipient; his *cost avoided* is already expressed in terms of money.[69]

This difference can be seen in a simple example involving a construction contract.[70]

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67. The terms *loss on the bargain* and *other loss* are used here in preference to the more popular "gains prevented" (*lucrum cessans*) and "losses caused" (*damnum emergens*). Under the latter terminology it is unclear, for example, whether what is here called *cost avoided* should be included under "gains prevented" or under "losses caused."

68. Bargains that call, for example, for an exchange of goods for goods, or of land for services, are the exception in our society. A more common sort of exception is the bargain that calls upon the party who is to pay money to do something else in addition. Examples are the *Groves* and *Peevyhouse* cases, discussed in text accompanying notes 100-20 *infra*. There are undoubtedly many bargains in which, although one party's performance is expressed in terms of the payment of money, the value of performance to the other party should theoretically take into account the enhancement of his experience or reputation or good will, for example, a contract between a fledgling portrait painter and a distinguished subject. English courts have recognized a right of recovery for such value in some cases. *E.g.,* Herbert Clayton & Jack Waller, Ltd. v. Oliver, [1930] A.C. 209, 220 ("Here both parties knew that as flowing from the contract the plaintiff would be billed and advertised as appearing at the Hippodrome, and in the theatrical profession this is a valuable right."). The practical importance of this is greatly reduced by the difficulty of meeting the standard of certainty, discussed in text accompanying notes 279-81 *infra,* with respect to such increments of value.

69. Furthermore, *other loss* in the form of physical harm to person or property, is generally present only where the supplier is the party in breach.

70. A constuction contract is chosen as a simple example because it does not pose some of the problems that would arise, for example, under a contract for the sale of goods. Under a contract for the sale of goods, a buyer may be faced with a choice between accepting and rejecting the goods, a choice that is not available to an owner on whose land a structure has been erected. Under a contract for the sale of goods, a seller who has begun their manufacture may be faced with a choice between stopping manufacture upon the buyer's breach and completing manufacture, a choice that is not available to a builder engaged in erecting a structure on another's land. *See* text accompanying notes 163-65 *infra.*

Illustration 3. Builder contracts with Owner to construct a factory on Owner's land for $1,000,000 payable on completion.

If the recipient (Owner) is the party in breach and the supplier (Builder) has used the breach to excuse himself from performance, the controversy will center on the *cost avoided* by Builder through his not having to complete construction of the factory after breach. The *loss in value* to Builder will be simply the amount remaining unpaid. If, however, the supplier (Builder) is the party in breach, by refusing to construct the factory or by constructing it improperly, the controversy will center on the *loss in value* to Owner that resulted from the breach. Here the *cost avoided* by Owner will be simply the amount remaining unpaid.[71]

When the recipient (Owner) is in breach, the simplest case is that in which Builder has finished the work.

Illustration 3a. The facts being otherwise as stated in Illustration 3, Owner breaches by refusing to pay after Builder has finished performance. Builder sues Owner for damages.

Here the loss in value to Builder is $1,000,000,[72] and since there was no *cost avoided,* this is also Builder's *loss on the bargain.* Assuming no *other loss,* Builder's damages under Formula A are $1,000,000.

Almost as simple is the case of breach by the recipient (Owner) where Builder has done nothing by way of performance or preparation for performance.

Illustration 3b. The facts being otherwise as stated in Illustration 3, Owner breaches by repudiating the contract soon after its making, and before Builder has done anything in performance or preparation for performance. It would have cost Builder $900,000 to build the factory. Builder sues Owner for damages.

Here the *loss in value* to Builder is $1,000,000, and his *cost avoided* is $900,000, making his *loss on the bargain* $100,000, which happens to be the profit that he would have made had both parties fully performed. Again assuming no *other loss,* this would be his recovery under Formula A. In practice, of course, the determination of the cost to Builder to complete the contract, in order to find the *cost avoided,* involves stubborn problems of proof, one of which goes to the extent to which Builder must include items of overhead in this figure.[73]

71. If the controversy arises out of Builder's claim to the amount remaining unpaid, he will be barred from any recovery under the contract if he cannot show substantial performance. *See* 3A CORBIN §§ 700-12. In this event, Owner's general measure of recovery operates as a floor, and Builder may well forfeit a larger amount depending upon how much of the price remains unpaid.

72. Construction contracts commonly provide for progress payments, not for payment on completion as in Illustration 3, so that the amount remaining unpaid upon Builder's completion of performance is ordinarily only a fraction of the total price. To the extent that such payments have been made, Builder's recovery should be accordingly reduced. This obvious adjustment for part payments has been omitted from the formulas and discussion for the sake of simplicity.

73. *E.g.,* Vitex Mfg. Corp. v. Caribtex Corp., 377 F.2d 795 (3d Cir. 1967). The prob-

Although the profit sought is the profit that this Builder, not some hypothetical builder, would have realized, a court may well mistrust his own optimistic estimates and rely on the testimony of experts.[74]

A more difficult and revealing example lies between these two extremes, when Owner's breach occurs before completion but after Builder has begun performance, or at least preparation for performance, and has incurred expenses which either cannot be returned to him, such as materials affixed to Owner's land, or cannot be put to other use, such as plans and drawings made to suit Owner's needs.

> *Illustration 3c.* The facts being otherwise as stated in Illustration 3, Owner breaches by repudiating the contract after Builder has begun performance, at a time when it would have cost him $400,000, out of a total cost of $900,000, to complete the factory. Builder sues Owner for damages.

Here, again assuming no *other loss*, Builder's recovery under Formula A is simply his *loss on the bargain*, which is equal to the *loss in value*, $1,000,000, less *cost avoided*, $400,000, or $600,000. In practice, of course, it is no simple matter to determine the *cost avoided*, the amount that it would have cost Builder to finish performance.[75] One way for Builder to meet his burden with respect to this figure is to use the information usually available to him with regard to the costs already incurred in reliance on the contract. The *cost of reliance*, which in Illustration 3c would necessarily be $500,000, is then subtracted from the estimated *cost of complete performance*, $900,000, to give $400,000.[76]

Cost avoided = cost of complete performance — cost of reliance.

Therefore, a convenient alternative for calculation of the *loss on the bargain* is simply to add the *cost of reliance, here* $500,000, to the estimated *profit,* here $100,000, which again gives $600,000.

Loss on the bargain = cost of reliance + profit.

lem of overhead saved by a builder or manufacturer is discussed in Harris, *A General Theory for Measuring Seller's Damages for Total Breach of Contract,* 60 MICH L. REV. 577, 588-92 (1962); Note, *Seller's Recovery When Buyer Repudiates Before Completion of Manufacture,* 99 U. PA. L. REV. 229, 232-33 (1950). The Code gives little help in this area. *See* UCC §§ 2-704(2), 2-708(2). A leading case before the Code is Jessup & Moore Paper Co. v. Bryant Paper Co., 297 Pa. 483, 147 A. 519 (1929).

The burden of persuasion as to *cost avoided* is generally on the injured party. *E.g.*, Allen, Heaton & McDonald v. Castle Farm Amusement Co., 151 Ohio St. 522, 86 N.E.2d 782 (1949) (suit by advertising agency on contract to provide services). In the "correspondence school" cases, however, courts have been unusually willing to allow the school to recover the full price of the course, at least unless the student in breach can show the school's *cost avoided. E.g.*, International Correspondence School, Inc. v. Crabtree, 162 Tenn. 70, 34 S.W.2d 447 (1931); La Salle Extension Univ. v. Ogburn, 174 N.C. 427, 93 S.E. 986 (1917). *See* notes 204-05 *infra.*

74. *See* Patterson, *Builder's Measure of Recovery for Breach of Contract,* 31 COLUM. L. REV. 1286, 1292-94 (1931).

75. There is a thorough discussion of this in Harris, *supra* note 73.

76. To the extent that Builder has savings that result from salvage, for example, through materials that can be put to other use, they should be excluded from *cost of reliance* and included in *cost avoided.*

This gives Formula B as an alternative to Formula A:

(B) *Damages* = *cost of reliance* + *profit* + *other loss.*[77]

It is important to realize that the *cost of reliance* enters only as a means of arriving at the *cost avoided.* There is no assumption that Owner has recieved a comparable benefit or, indeed, any benefit at all. Nor is there any assumption that the expenses that go to make up the *cost of reliance* were reasonable expenses.[78] However, the profligate builder, who has incurred unreasonable expenses, may encounter difficulty in his attempt to prove *profit.*[79]

When it is the supplier (Builder) rather than the recipient (Owner) who is in breach, it is *loss in value* and not *cost avoided* that is the troublesome component in determining the *loss on the bargain.*

> *Illustration 3d.* The facts being otherwise as stated in Illustration 3, Builder breaches by failing to follow the contract specifications, and Owner sues Builder for damages.

Disregarding *other loss,* Owner's recovery under Formula A is equal to his *loss on the bargain* calculated as the difference between *loss in value* and *cost avoided.* Since *cost avoided* is simply the amount yet unpaid by Owner, or $1,000,000 if he has paid nothing, *loss in value* is the only troublesome component.

For a typical commercial structure, such as a factory that is to be used for profit, an estimate of the *loss in value* to Owner can be derived from the loss, resulting from the breach, in the income that he would have realized in collateral transactions with other parties.[80] Where he is a middleman who intends to lease or sell the structure to another, this estimate is based on the loss in the rental or sale price. Where he is the ultimate user of the structure and anticipates manufacturing a product for sale to others, the estimate is based on the loss in income from such sales.[81] The ultimate user presents the more difficult problem of estimation of *loss in value* and here a more refined terminology will help.[82]

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77. Where Builder has been delayed by Owner's breach, prior to Builder's decision to treat that breach as total, loss caused by that delay should be treated as *other loss.*

78. Under the rules relating to mitigation, however, Builder will be held to a standard of reasonableness with respect to savings that might have resulted from salvage.

79. *See* Patterson, *supra* note 74, at 1289-91.

80. To the extent that the income is deferred income, it will have to be capitalized, a problem that is ignored here for the sake of simplicity. *See* 1 J. Bonbright, *supra* note 62, at 216-32.

81. The same is true where the breach consists of a delay in completion. Owner will be allowed damages based on the difference between the income that the factory would have produced had performance been timely and that which it will produce as a result of the delay. He is not confined to the rental price of the premises during the delay, the price that some hypothetical lessee would have paid on the market for their use during that period.

82. As will be seen later, the ultimate user also poses the more difficult problems with regard to unforeseeable loss, text accompanying notes 219-76 *infra,* and uncertain loss, text accompanying notes 277-303 *infra.*

The cost of complete performance by Owner of his bargain with Builder (here, the payment of $1,000,000) will be referred to as the *cost of complete direct performance* and will be regarded as being made up of the *cost of direct reliance* (payments already made by Owner to Builder) and the *direct cost avoided* (payments not yet made by Owner to Builder). The cost of complete performance by Owner of collateral transactions will be referred to as the *cost of complete collateral performance* and can be regarded as being made up of the *cost of collateral reliance* (cost already incurred in those transactions) and the *collateral cost avoided* (cost avoided by not completing those transactions).[83] Owner's profit on his bargain with Builder will be called his *direct profit* and is equal to the *collateral income lost* (the income that he has lost on collateral transactions) less both the *cost of complete direct performance* and the *cost of complete collateral performance*.[84] Using this terminology, then, the *loss in value* of the structure to Owner as a result of the breach is readily seen as equal to the difference between the *collateral income lost* and the *collateral cost avoided.*

Loss in value = collateral income lost — collateral cost avoided.

Substitution of this in Formula A gives Formula A′:

(A′) *Damages = collateral income lost — collateral cost avoided — direct cost avoided + other loss.*

Disregarding *other loss,* where Owner has yet done nothing in either direct or collateral reliance, his damages will be simply his *direct profit.* If, for example, the *collateral income lost* is $20,000,000, and the *collateral cost avoided* is $17,-000,000, damages, assuming no other loss, will be equal of the first of these less the second and less the $1,000,000 that Owner would have had to pay Builder for the factory, or $2,000,000.

Often, however, Owner will already have made commitments or expenditures in anticipation of collateral transactions. He may, for example, have ordered machinery to be installed in the factory and incurred expenses for advertising its future products. In order to reflect this *cost of collateral reliance* more clearly, Formula A′ can be transformed into Formula B′ by a process similiar to that used to transform Formula A into Formula B.[85]

83. Fuller & Perdue, *supra* note 12, at 78, use the terms "essential reliance" and "incidental reliance" instead of *direct reliance* and *collateral reliance.* The latter terms are used here as parallel to the commonly used terms *direct profit* and *collateral profit.*

84. Owner's profit on collateral transactions, or his *collateral profit,* would be calculated with no deduction for the cost of *complete direct performance* and would be equal to the *collateral income lost* less the *cost of complete collateral performance.*

85. The equivalence of the two formulas can be established by showing that:
collateral income lost — collateral cost avoided — direct cost avoided = cost of direct reliance + cost of collateral reliance + direct profit
Rearranging the terms gives:
collateral income lost = (cost of direct reliance + direct cost avoided) + (cost of collateral reliance + collateral cost avoided) + direct profit
And substitution gives:
collateral income lost = cost of complete direct performance + cost of complete

(B′) *Damages = cost of direct reliance + cost of collateral reliance + direct profit + other loss.*

Assuming, for example, that Owner had spent $500,000 on machinery and advertising in collateral reliance, his damages would equal this amount plus the $2,000,000 direct profit.[86]

Where, however, the injured party's expected advantage does not consist largely or exclusively of the realization of profit, but involves substantial matters of personal taste or welfare, both formulas, A′ and B′ are inadequate. The practical problems of determining his recovery are apparent. The division between judge and jury of the power to determine damages requires a fairly simple and objective measure that can be administered by jurors and supervised by judges in accordance with the requirement of certainty. Yet where matters of personal taste or welfare are concerned, only the injured party himself may be able to shed light on his actual "state of mind" or "favorable attitude," and he can hardly be expected to give dispassionate testimony on the subject. Although market prices and the opinions of experts can be used to test his claims, courts have been reluctant to take account of such loss and have often expressed their reluctance by saying that there can be no recovery for "sentimental" or for "fanciful" value.[87] As to matters of personal taste and welfare, therefore, courts have frequently felt compelled to look to objective measures to approximate value to the injured party. It should be borne in mind, however, that diminution in value is still the basis for recovery, and that what is sought is merely a measure of that diminution in value and not a distinct basis of recovery.[88]

The two most common measures are cost to complete and diminution in market price.

> *Illustration 4.* Builder contracts with Owner to build a house on Owner's land for $50,000, paid in advance. Builder fails to follow the contract specifications. The cost to Owner to have another builder complete performance would be $15,000. The difference between the price that the house and land would have brought on the market if the

collateral performance + (*collateral income lost* — *cost of complete direct performance* — *cost of complete collateral performance*).

86. Since *direct profit* has been defined to exclude both the *cost of complete direct performance* and the *cost of complete collateral performance*, double recovery is avoided. *Cf.* Fuller & Perdue, *supra* note 12, at 82-83.

87. Most of the discussion of "sentimental" and "fanciful" value has come in connection with the owner's claim for loss or damage to property for which he has a special attachment, a type of claim that more commonly sounds in tort than in contract. Illustrative is MacGregor v. Watts, 254 App. Div. 904, 5 N.Y.S.2d 525, 526 (1938), an action in conversion for the loss of a manuscript of a play, in which the court stated that "all sentimental or fanciful values are eliminated and disregarded." *See* 5 CORBIN § 1004; MCCORMICK § 44 at 169-70; 1 J. BONBRIGHT, *supra* note 62, at 350-53. *See also* the discussion of the requirement of certainty in text accompanying notes 277-303 *infra*.

88. Fuller & Perdue, *supra* note 12, at 65-66, suggest that were it not for such factors as the natural preference for the expectation interest on the ground that it offers the most easily administered standard, one would expect a tendency away from expectation and towards reliance as one progresses away from a credit system. The further removed the contract is from the credit system, the more difficult it is to measure expectation, and the less pressing are the basic policies that justify protection of the expectation interest in the ordinary business agreement.

> specifications had been followed and that which it will bring as built is $10,000. Owner sues Builder for $15,000 in damages.

Damages measured by the cost to Owner to complete performance are subject to the objection that they may compensate him for more than the diminution in value to which the laws says he is entitled. If the cost to complete performance, here $15,000, exceeds the diminution in value to him, so that it would not be "worth what it would cost" for him to complete, then damages measured by that cost will leave him with a windfall in the amount of the excess. To allow this windfall would be to go beyond protection of his expectation and, in effect, penalize Builder, thereby departing from the principal objective of contract remedies. Cost to complete is, however, useful in fixing an upper limit for recovery since, even if that cost is less than the diminution in value to him making it advantageous for him to complete, the "principle of substitution" operates so that damages measured by that cost will at least be sufficient to enable him to obtain a substitute performance.[89]

Damages measured by the diminution in the price that Owner could realize on the market,[90] here $10,000, avoid the above objection, but are subject to the converse objection that they may undercompensate Owner. If Owner planned to keep the building for his own use, the advantage that he expected may well exceed that to those who would buy on the market. As Bonbright pointed out,

> many properties, highly prized for the special purposes for which they are designed, are of trivial value [on the market] because only the present owner is in a position to exploit them.[91]

To this extent of this excess, damages measured by the decline in market price will fail to compensate Owner for his loss in value. But if he anticipated selling the building on completion, damages measured by the price that the building would have brought him in a hypothetical sale on the market may closely approximate its value to him. Diminution in market price is, therefore, useful in fixing a lower limit for recovery, since the value of property to its owner is usually no less than the net price at which he could sell it.

When diminution in value is elusive, then, cost to complete is a useful measure in fixing an upper limit for recovery and diminution in market price is a useful measure in fixing a lower limit.[92] The diminution in value to Owner in Illustration 4, for example, can be assumed to lie between $10,000 and $15,000.

89. According to Bonbright, the rule "that replacement costs sets the approximate upper limit of . . . value" is "one of the most useful rules of thumb" in appraisal theory. 1 J. BONBRIGHT, *supra* note 62, at 157. The "principle of substitution" is discussed in text accompanying notes 166-69 *infra*.

90. Bonbright calls this "the highest price for which the owner could sell it, under prevailing conditions of the market." 1 J. BONBRIGHT, *supra* note 62, at 56.

91. 1 J. BONBRIGHT, *supra* note 62, at 66.

92. Disregarding the element of damage due to delay in completion, the cost to complete operates as an upper limit on *diminution in market price*, so that damages measured by cost to complete will not be less than damages measured by diminution in market price.

Which measure more closely approximates this diminution in value will depend on the circumstances. When damages measured by cost to complete will not greatly exceed those measured by diminution in market price, so that the error will not be large whichever is chosen, courts generally favor the former as the more generous of the two.[93] Owner can therefore expect to recover $15,000 in Illustration 4. Where, however, they differ widely, the preference may shift to damages measured by diminution in market price.

In some cases the contract itself may suggest which measure gives the better approximation of value to Owner.

> *Illustration 4a.* The facts being otherwise as stated in Illustration 4, the contract states that of the $50,000 price, $40,000 is for the house itself and $10,000 is for ornamental sculpture on its exterior. Builder's departure from specifications consists of his failure to add the sculpture. Although the cost to Owner to have another builder add the sculpture would be $15,000, its addition would raise the market price of the property by only $1,000.

Here the figures for cost to complete and diminution in market price show only that the diminution in value to Owner, because of Builder's failure to add the sculpture, lies between the disparate limits of $1,000 and $15,000, but the fact that when the contract was made Owner was evidently willing to pay $10,000 for it, suggests that $15,000 is the more appropriate approximation of diminution in value to him at the time of breach.[94] This, in fact, will ordinarily be the measure of his recovery in such a case. As one court put it:

> A man may do what he will with his own, . . . and if he chooses to erect a monument to his caprice of folly on his premises, and employs and pays another to do it, it does not lie with a defendant who has been so employed and paid for building it, to say that his own performance would not be beneficial to the plaintiff.[95]

Yet to the extent that Owner's expected advantage consists of the realization of profit to the exclusion of matters of personal taste and welfare, diminution in market price may be the better measure of that benefit.[96] If, for example, Owner is a developer who plans to place the house on the market, and if his earlier willingness to pay $10,000 for the sculpture was due simply to his gross miscalculation, at the time the contract was made, of the effect that it would have

93. RESTATEMENT § 346(1)(a)(i), for example, states a basic rule allowing damages for "the reasonable cost of construction and completion in accordance with the contract." *See also* Illustration 4 to that section.

94. The value of the sculpture on which damages are to be based, however, is its value to the owner at the time of breach and not the value that he thought, at the time of contracting, it would have. Bonbright discusses "real" and "esteemed" value in 1 J. BONBRIGHT, *supra* note 62, at 82-84.

95. Chamberlain v. Parker, 45 N.Y. 569, 572 (1871) (Andrews, J.).

96. In Chamberlain v. Parker, *id.* at 572-73, the court continued: "The point to be considered is, whether the plaintiff in any sense, actual or legal, has lost by the default of the defendant a sum equal to the expense of digging the well," *i.e.*, the cost of completion. It held that he had not.

on the market price of property, $1,000 is a more appropriate approximation than $15,000 of the diminution in value to him at the time of breach.[97]

At this point, the skeptical reader may well suspect that this is an instance in which it is difficult for judges to suppress the natural inclination to take some account of fault in contract matters. Should the developer who plans to market the house be limited to $1,000 even if it appears that Builder's breach resulted from his discovery that to add the sculpture would cost him, say, $14,000, compared to the $10,000 allocated in the contract, and that rather than absorb the resulting $4,000 loss he decided it would be cheaper to refuse to perform and pay $1,000 damages instead? If relief of promisees to redress breach is the only objective, he should be so limited. As might be supposed, however, where the breach appears to have been the result of such a decision, courts have been reluctant to accept this conclusion. Rather than favor the party in breach by ascribing a discrepancy between contract price and market price to the injured party's gross miscalculation, at the time the contract was made, of the effect that performance would have on the market price of the property, the natural inclination is to favor the injured party by attributing his willingness to pay so high a price to some advantage that is peculiar to him and not, therefore, reflected in the market price.[98] The fact that the breach was "willful" or "deliberate" may, therefore, be seen by the court as an additional argument for using cost to complete, and not diminution in market price, as the measure of damages in cases like Illustration 4a.

The argument for using cost to complete are weaker when the contract itself sheds no light on value to Owner.

> *Illustration 4b.* The facts being otherwise as stated in Illustration 4a, the contract does not allocate the $50,000 price between the house and the sculpture.

Here there is less justification for assuming that the loss in value because of the failure to add the sculpture is substantially greater than $1,000. It is still possible that had the parties allocated a figure in the contract to the sculpture alone, it might still have been $10,000; but it is also possible that it might have been only $1,000, and that the discrepancy between this figure and the $15,000 figure for cost to complete might be due to a gross miscalculation made by Builder of what his own costs would be in adding the sculpture.[99] On that assumption, the $15,000 approximation measured by cost to complete is less appealing, and the $1,000 approximation measured by diminution in market price seems closer to

97. This would be so regardless of whether he simply misjudged the existing market at the time of contracting or whether he correctly judged it then only to have it fall before breach.

98. The house to be marketed by the developer might, for example, be intended as a prototype to stimulate other sales.

99. It is unlikely that it would be due primarily to an increase in costs between contracting and breach, since this would probably be reflected in an increase in market price as well.

the probable value to Owner. Courts have been particularly baffled by such situations in which the contract calls for more than one sort of performance with no allocation of the return performance which would suggest their relative values to the injured party.

Two leading decisions are the Minnesota case of *Groves v. John Wunder Co.*,[100] and the Oklahoma case of *Peevyhouse v. Garland Coal Mining Co.*[101] In *Groves*, one party agreed to lease to the other, with the right to excavate, a twenty-four acre tract of industrial property. The lessee paid $105,000 and promised to leave the property at a uniform grade. Instead it left the grade uneven. Had the lessee performed, the market price of the property upon termination of the lease would have been $12,160; for the owner to have the grading done would have cost upwards of $60,000. The owner sued for damages measured by the latter figure, but recovered only damages measured by the $12,160. On appeal, it was held that the trial court erred in limiting the owner to damages measured by market price.[102] In *Peevyhouse*, the owners of a farm leased it to a mining company for five years for strip-mining. The lessee paid a sum of money and promised to do restorative and remedial work on the land. It failed to do the work. Had the lessee performed, the market price of the farm would have been increased by only $300; for the owners to complete would have cost about $29,000. The owners sued for $25,000 and recovered $5000 in the trial court. On appeal, it was held that the trial court erred in allowing damages greater than those measured by market price and reduced the judgment to $300.[103]

In each case the party leasing for the purpose of excavation was in a position analogous to that of Builder. In each case the lessee's performance was to be of two sorts, paying money for the right to excavate and restoring the land after excavation. In each case the return performance was the lease with the right to excavate which was not, of course, allocated as between the payment and the restoration.[104] In each case the excavator paid the money, analogous to Builder's construction of the house, and in each case he failed to restore the land, analogous to Builder's failure to add the sculpture. In *Groves* the court concluded that cost to complete was the proper measure of damages; in *Peevyhouse* it concluded that diminution in market price was the proper measure.

In *Groves* the court stressed the "willful" character of the breach[105] and remarked that the "objective of this contract . . . was the improvement of real

100. 205 Minn. 163, 286 N.W. 235 (1939).
101. 382 P.2d 109 (Okla. 1962).
102. The decision was three to two, with two judges taking no part.
103. Four of the nine judges dissented.
104. In addition, the lessee in *Groves* incidentally eliminated the lessor as a competitor.
105. 205 Minn. at 165, 286 N.W. at 236. The dissenting opinion denied that there was any finding to support this characterization of the breach. 205 Minn. at 172, 286 N.W. at 239.

estate."[106] It evidently thought that the value to the owner of restoration was approximately $60,000 even though this was over half the amount paid for the lease and was nearly five times the market price of the land as restored. Had the sum to be paid for the lease originally been $165,000 with no provision for restorative work, and had the parties subsequently modified the agreement to reduce the price to $105,000 and include the restorative work, this conclusion would be difficult to dispute. But the court had no such convincing evidence to support its conclusion.

In *Peevyhouse* the court emphasized the "relative economic benefit" and "the relationship between the expense involved and the 'end to be attained'—in other words, the 'relative economic benefit.' "[107] It concluded that "the contract provision breached was merely incidental to the main purpose in view, and . . . the economic benefit which would result to lessor by full performance of work is grossly disproportionate to the cost of performance."[108] It evidently concluded that the value to the owner of the restoration was approximately $300, even though it would have cost the owner nearly a hundred times that amount to do it. Had the sum to be paid for the lease originally been fixed with no provision for restorative work, and had the parties subsequently modified the agreement to reduce the price by $300 and include the restorative work, this conclusion would be difficult to dispute. But this court, too, had no such convincing evidence to support its conclusion. Indeed, the fact that the property in *Groves* was industrial in character might have made market price a more appealing alternative,[109] and the fact that the property in *Peevyhouse* was a farm might have made cost a more appealing alternative, but both courts chose to ignore the character of the land involved.[110]

Both courts were met with and rejected the contention that recovery measured by cost to complete would involve "economic waste."[111] The term "economic waste" is, at the very least, misleading. It is commonly used in situations in which completion of performance would require demolition and reconstruction of a structure. The *Restatement of the Law of Contracts,* for example, says in this context that the owner may recover the "reasonable cost of

106. 205 Minn at 170, 286 N.W. at 238.
107. 362 P.2d at 113.
108. *Id.* at 114.
109. The opinion in *Peevyhouse* does not, however, indicate whether the owners planned to live on the farm after the land was restored.
110. It has been suggested that attention be given to

> the parties' purposes in making the contracts. If it appears from all the facts that the promisee was interested in the construction solely for its immediately effect upon the sale value of his adjacent property, the change in value [market price?] rule obtains; on the other hand, if he was interested in the construction either for its use value or as one step in a comprehensive scheme, cost of completion is granted. . . . Viewing the facts of this case [*Groves*] with the above criteria in mind it appears that a level grade was not uppermost in mind of the promisee at the time the contract was made; it dealt mainly with the removal of gravel. . . . In such a case the difference in value rule is indicated.

40 COLUM. L. REV. 323, 325-27 (1940).
111. 205 Minn. at 170-71, 286 N.W. at 238; 362 P.2d at 112.

construction and completion . . . if this is possible and does not involved unreasonable economic waste."[112]

Illustration 4c. The facts being otherwise as in Illustration 4b, the sculpture is to be built into the foundation in such a way that its addition, once the house has been completed, will require considerable demolition and reconstruction.

In this situation, Owner will usually be confined to damages measured by diminution in market price. In *Jacob & Youngs v. Kent*,[113] for example, a contractor built a $70,000 country residence for the owner, but inadvertently departed from the contract specifications by using the plumbing pipe of Cohoes, rather than of Reading Manufacture. The two types of pipe were identical in all characteristics except their origin, and to have replaced the Cohoes pipe with Reading would have required demolition of substantial parts of the structure. Judge Cardozo wrote for the New York Court of Appeals:

> In the circumstances of this case, we think the measure of the allowance is not the cost of replacement, which would be great, but the difference in value, which would be either nominal or nothing. . . . The owner is entitled to the money which will permit him to complete, unless the cost of completion is greatly out of proportion to the good to be attained. When this is true, the measure is the difference in value.[114]

The result seems not to have turned on the fact that the departure was inadvertent rather than intentional.[115] Presumably the court concluded that the nominal diminution in market price was a closer approximation to the loss in value to the owner than was the considerable cost of demolition and replacement. This is a reasonable conclusion in any situation in which the cost to complete has been substantially increased by the breach itself and consists in large part of undoing work already done and then redoing it, and only in small part of making improvements that directly affect the value to the owner. Loss in value to the owner is likely to be only a small fraction of the cost to complete, and damages measured by the diminution in market price are probably the better approximation of this.

It is misleading, however, to suggest that the *award of damages* measured by cost to complete would result in "economic waste" in such a situation. What is meant by "economic waste" seems rather to be a use of assets in a way considered "wasteful" according to standards shared by society in general.

112. RESTATEMENT § 346(1)(a)(i).

113. 230 N.Y. 239, 129 N.E. 889 (1921).

114. 230 N.Y. at 244, 129 N.E. at 891. *Accord*, Hansen v. Anderson, 246 Iowa 1310, 71 N.W.2d 921 (1955).

115. Because suit was by the contractor against the owner, there was also a question whether there had been substantial performance on the contractor's part, in the light of which the character of the owner's breach was regarded as significant. 230 N.Y. at 244, 129 N.E. at 891. Three judges dissented, arguing that there had not been substantial performance.

Certainly there would have been "economic waste" in this sense if the contractor in *Jacob & Youngs* had been compelled to replace the Cohoes pipe with Reading at a cost greatly in excess of what society in general, as evidenced by the market, would regard as the resulting increase in value. But awarding damages measured by cost to complete results in no such compulsion, for the law does not supervise the injured party's disposition of the money that he recovers as substitutional relief.[116] If he recovers a sum measured by cost to complete, he is free to choose whether he will "waste" it on completion or put it to other use. Even if he were limited to a lesser sum measured by diminution in market price, he will still be free to waste it along with other assets, on completion, and it is doubtful that recovery of the larger sum will appreciably increase the likelihood that he will do so.[117] It is perhaps more likely that the threat of damages measured by cost to the owner to complete might coerce the builder into correcting the defect himself, which he could probably do at somewhat lesser cost than could the owner; this course however, would probably be less attractive to both parties than settlement at some figure short of the cost to the builder but above the difference in market price.

Much of the talk of "economic waste" thus misses the mark. Usually the only valid point to be made is that there is the probability of an excessive windfall for the owner and a heavy penalty for the builder if cost to complete rather than diminution in market price is adopted as the measure of loss in value. This is so where, as in *Jacob & Youngs,* much of the cost to complete results from the breach itself and consists of expenses in undoing and redoing work that is not directly productive of value to the injured party, so that there is reason to suppose that the loss in value to him is much farther from cost to complete and closer to diminution in market price than it would otherwise be. But on this analysis the "economic waste" argument is a spurious one in both *Groves* and *Peevyhouse.* There was no suggestion in either case that the cost to complete was increased by the breach and would have been less had restoration been carried out during the regular course of the lessee's operations. Although it is possible to imagine a situation in which restoration at the end of the lease would involve undoing and redoing work to achieve an end that could have been attained much more efficiently had it been done over the period of the lease, it does not appear that this was so in either case.[118] As far as can

116. As has already been pointed out, courts are particularly reluctant to give specific relief to the owner for breach of a construction contract. Text accompanying note 34 *supra.*

117. The subsequent history of *Groves* supports this. After the reported decision, the lessee paid $55,000 to the owner to settle the claim. The land was left until 1951, when some grading was done on a portion at a cost of $6,000 and in 1953 this portion was sold for $45,000 to a buyer who planned to use it for a factory. J. Dawson & W. Harvey, Cases on Contracts and Contract Remedies 12 (2d ed. 1969).

118. It is sometimes suggested that, as the court said in *Peevyhouse,* "the 'economic waste' referred to consists of the destruction of a substantially completed building or other structure." 382 P.2d at 112. *See also* Restatement § 346, Comment b. To the extent that

be seen, all of the cost of the restorative work included in the $60,000 and $29,000 figures was that contemplated at the time of the contract.

All this does not suggest that the court should have measured damages by cost rather than market price in *Peevyhouse* or by market price rather than cost in *Groves*. It merely suggests that there was little reason in either case to prefer the one to the other. If, in fact, the value to the owner in both cases lay somewhere between the two extremes, the solution reached by the trial court in *Peevyhouse* accords with common sense. Rather than accept the Draconian choice between the Scylla of overcompensation through cost and the Charybdis of undercompensation through market price, it gave judgment for an intermediary amount, $5,000, roughly a sixth of the cost of completion, but over fifteen times the diminution in market price.[119] It was reversed, but it is indeed doubtful that the appellate court improved upon the compromise in the court below. The "certainty" achieved by insisting on a choice between cost or market price is plainly illusory if there is no reliable way of connecting either of the two measures to the loss in value to the owner. Where the loss in value to the owner is uncertain, and cost to complete and diminution in market price differ widely, it would be better to give the trier of fact discretion to fix any figure, not unreasonable under the circumstances, as long as it lies within those two limits. On this basis, then, both *Groves* and *Peevyhouse* were wrongly decided.[120]

V. SECOND CHOICE REVISITED: ALTERNATIVES TO EXPECTATION

Ordinarily the injured party will be content to base his recovery on his expectation interest, since this will be more favorable to him than recovery based on either his restitution interest or his reliance interest. There are, however, some exceptions.

One instance in which restitution may appear an attractive alternative occurs when the party in breach has committed a total breach in spite of the fact that the bargain has turned out to favor him — that is, when the value to the party in breach of the benefit conferred upon him would exceed the value of his promised performance to the injured party. Needless to say, this sort of situation is not common since there is usually no reason for the more favored party to refuse to perform his part of a bargain that is favorable to him. Nevertheless, when this situation does arise, restitution is allowed if the

the "economic waste" argument has any merit, however, it is applicable to any situation which involves undoing and redoing work, whether or not a structure is involved.

119. Since the trial court arrived at its $12,160 figure in *Groves* by concluding that the land as surrendered to Groves was "without any value," neither the $60,000 nor the $12,160 was an "intermediary amount." J. DAWSON & W. HARVEY, *supra* note 117, at 2 n.1.

120. This point is made more eruditely, if more abstrusely, in Birmingham, *Damage Measures and Economic Rationality: The Geometry of Contract Law*, 1969 DUKE L.J. 49. For a case in which the matter was disposed of by a clause in the contract calling for reimbursement for expenses incurred by the aggrieved party, *see* Eastern S.S. Lines v. United States, 112 F. Supp. 167 (Ct. Cl. 1953).

benefit conferred on the party in breach consists simply of the payment of money.[121]

> *Illustration 3e.* The facts being otherwise as stated in Illustration 3, Owner pays the $1,000,000 in advance and Builder breaches by failing to construct the factory. Owner sues Builder for return of the full $1,000,000, although the value of the factory to Owner would in fact have been only $700,000.

Owner will be allowed restitution of the full $1,000,000, with no deduction for the $300,000 loss he would have suffered had Builder constructed the factory. Owner's position after the breach is consequently better than it would have been had Builder performed.

Restitution is not, however, generally allowed where the benefit conferred on the party in breach consists of something other than the payment of money.[122]

> *Illustration 3f.* The facts being otherwise as stated in Illustration 3, Builder constructs the factory in advance and Owner breaches by failing to pay the price. Builder sues Owner for $2,000,000, the actual value of the factory to Owner, rather than for the $1,000,000 that Owner promised to pay.

Here Builder's recovery will be limited to the $1,000,000 promised, which was the limit of his expectation. The results in Illustrations 3e and 3f, both of which favor the party who has agreed to pay money, can be reconciled on the ground that in each case the court chooses the measure of recovery that permits it to avoid the problem of determining loss in value due to nonperformance of the promise to do something other than pay money.[123] If, however, the benefit conferred on the party in breach consists of other than the payment of money, and if the injured party has performed only in part, as where Owner breaches by repudiating when Builder is in the process of constructing the factory, the problem of valuation cannot be avoided. Here courts have generally allowed recovery based on the restitution interest, a point that will be illustrated shortly in connection with the protection of the reliance interest in this situation.[124]

Dawson points out a second instance in which recovery based on the

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121. Bush v. Canfield, 2 Conn. 485 (1818), discussed in Palmer, *The Contract Price as a Limit on Restitution for Defendant's Breach*, 20 OHIO ST. L.J. 264-65 (1959); RESTATEMENT § 347(1)(a).

122. *E.g.*, Oliver v. Campbell, 43 Cal. 2d 298, 273 P.2d 15 (1954); RESTATEMENT § 350.

123. For this reason RESTATEMENT § 350 allows restitution where, for example, the injured party has parted with goods in return for a promise to perform services. *See* Palmer, *supra* note 121, at 267.

124. RESTATEMENT §§ 347(1)(a), 351. *See* text accompanying notes 132-38 *infra*. The formulas for recovery based on the expectation interest and the restitution interest, respectively, have a discontinuity at the line between part and full performance. An example is Oliver v. Campbell, 43 Cal. 2d 298, 273 P.2d 15 (1954), in which a five-judge majority held that a lawyer had fully performed his services for his client and was limited to the $750 fee that they had fixed, while two dissenting judges contended that the services were not fully performed so that he was entitled to their reasonable value, $5,000.

restitution interest, broadly conceived, might exceed the expectation.[125] This occurs where one party refuses to perform so that he may take advantage of another, more attractive, opportunity.

> *Illustration 3g.* The facts being otherwise as stated in Illustration 3, Builder would have made a profit of $100,000 on this contract. Immediately after making the contract, he receives from another owner an offer of a contract under which he can make a profit of $300,000. He accepts it, although he cannot do both jobs, and repudiates his contract with Owner. Owner sues Builder for restitution of the $200,000 additional profit that Builder made as a result of his breach, although it appears that Owner would not have made a profit had the factory been built.

Dawson concludes, however, that Owner would be denied recovery of the $200,000:

> This kind of recovery could not be explained as restitution under present day tests; there would be a fatal break in the chain of causation, for the asset or conduct that was merely promised would not have come *from* the promisee [Owner]. Perhaps another way to express the idea is that the prevention of profit through mere breach of contract is not yet an approved aim of our legal order, as it is with breach of "fiduciary" duties.[126]

The limits on the restitution interest as a basis of recovery, therefore, usually make it unattractive to the injured party as an alternative to the expectation interest. The reliance interest, however, is more promising.

One instance in which the injured party might prefer recovery based on his reliance interest occurs when his expectations under the contract were less than his expectations under some other bargain that he declined in reliance on the contract.

> *Illustration 3h.* The facts being otherwise as stated in Illustration 3g, Builder would have made a profit of $100,000 on this contract. Builder rejects the other offer because he cannot do both jobs. Owner then breaches by repudiating the contract after it is too late for Builder to accept the other offer. Builder sues Owner for $300,000 in damages, based on what he lost in reliance on his contract with Owner, rather than for $100,000 based on what he lost in disappointed expectations upon its breach.

Although $300,000 would be required to put Builder in the position in which

125. Dawson, *Restitution or Damages?*, 20 OHIO ST. L.J. 175, 186-87 (1959).

126. Dawson, *supra* note 125, at 187. He cites Acme Mills & Elevator Co. v. Johnson, 141 Ky. 718, 133 S.W. 784 (1911), in which a seller failed to deliver wheat which he had contracted to sell for $1.03 a bushel, sold it before the delivery date to another buyer for $1.16 a bushel, and was held liable for nominal damages only when the market dropped below the contract price by the delivery date. *See also* RESTATEMENT (SECOND) OF AGENCY § 404 (1957), Illustration 2. But in Timko v. Useful Homes Corp., 114 N.J. Eq. 433, 168 A. 824 (1933), it was held that a vendor of lots, for which the purchaser had partly paid, held them in trust for the purchaser and was liable to him for damages based on the price at which he wrongfully sold them to a third party.

he would have been had he not made the contract with Owner,[127] no court would allow him this larger sum. A court will not, as Fuller and Perdue stated it, "knowingly put the plaintiff in a better position than he would have occupied had the contract been fully performed."[128] Expectation here operates as an upper limit on recovery, a defensible limit since one of the justifications for the protection of the expectation interest in the first place is that it yields rules that are superior, because of their certainty and ease of application, to those derived from the reliance interest.[129] Businessmen regularly rely on contracts by foregoing other opportunities and adjusting their business to the expected performance, and basing recovery on such reliance would pose grave problems of measurement.

A second exceptional case, in which the injured party may prefer damages based on reliance to those based on expectation, arises when the breach has relieved him from finishing performance of what has turned out to be a losing contract.[130]

> *Illustration 3i.* The facts being otherwise as stated in Illustration 3, Owner breaches by repudiating the contract after Builder has begun performance. Builder has already spent $500,000 and would have to spend $600,000 more to finish performance, which would result in a $100,000 loss on the contract. Builder sues Owner for $500,000 in damages, based on his expenditures in reliance on the contract and ignoring the $100,000 loss, rather than for the $400,000 to which he would otherwise be entitled.

Here too, for reasons similar to those given in connection with the previous exception, most courts have persisted in limiting recovery on the contract to that based on expectation so that breach does not have the consequence of shifting to the party in breach a loss that would have been suffered by the injured party had the contract been fully performed.[131] In an illustrative case,

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127. To eliminate the possibility that Builder might have repudiated the contract with Owner and accepted the more profitable offer, remaining liable to Owner for damages, assume that those damages would be at least $200,000, so that this course of action would have been less desirable for Builder.

128. Fuller & Perdue, *supra* note 12, at 79. *See also* their discussion of the compensability of gains prevented through reliance at 417-18.

129. *Id.* at 61-62. They also suggest that

> in a hypothetical society in which all values were available on the market and where all markets were "perfect" in the economic sense . . . there would be no difference between the reliance interest and the expectation interest. The plaintiff's loss in foregoing to enter another contract would be identical with the expectation value of the contract he did make.

Id. at 62. They give the illustration of a "physician who by making one appointment deprives himself of the opportunity of making a precisely similar appointment with another patient . . . ." *Id.* at 74.

130. It may be that the injured party entered into the contract because of some special advantage, such as the enhancement of his experience or reputation or good will, with respect to which his proof fails to meet the standard of certainty, discussed in text accompanying notes 277-303 *infra.* What he then regarded as an advantageous contract may thus appear as a "losing" contract. *Cf.* note 68 *supra.*

131. *See* RESTATEMENT § 333. This means that not only is the *cost of reliance* limited by the contract price in an extreme case, but that a negative profit term must be included

Millen v. Gulesian,[132] the Supreme Judicial Court of Massachusetts approved an award to Builder of only $3,057, calculated as the difference between the contract price of $8,825 and the cost avoided of $5,768. The Builder, as the injured party, had sought recovery of $7,625, the amount of his costs incurred in reliance on the contract. Despite owner's breach, builder's recovery was thus less than his cost of reliance by $4,568, the amount he would have lost had the contract been fully performed.[133] However, as has already been mentioned, Builder is generally allowed restitution of the benefit that he has conferred upon Owner, to put the party in breach in the position in which he would have been had the contract not been made.[134] Some courts, therefore, have been able to avoid the limitation applicable to recovery on the contract by characterizing the reasonable cost of part performance as the benefit to the Owner,[135] ignoring the fact that there may be a difference between recovery based on the reliance interest and that based on the restitution interest. The language of the Supreme Court of Pennsylvania in one such case, *Philadelphia v. Tripple*,[136] is representative of this view:

> It may, of course, be contended that [Owner] did not receive an actual benefit co-extensive with [Builder's] expenditure. It is a sufficient answer to this contention to observe that . . . [Builder] expended the money in good faith and in the course of attempted performance.[137]

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to account for any loss. When the party in breach is a seller of goods, however, the buyer may elect to reject the goods and cancel the contract. By doing so, he puts himself in the position he would have been in had there been no contract, and since he seeks no damages, he need take no account of any loss he would have had on the contract. *See* Peters, *Remedies for Breach of Contracts Relating to the Sale of Goods Under the Uniform Commercial Code: A Roadmap for Article Two*, 73 YALE L.J. 199, 270-71 (1963).

132. 229 Mass. 27, 118 N.E. 267 (1917). Adjustment was made for interest and for $1,100 already received by Builder on account.

133. Fuller & Perdue, *supra* note 12, at 77, suggest, however, that

> it is quite possible in a case of a particularly inexcusable breach that the court might feel that it was not imposing too heavy a penalty on the defendant to shift to him the loss which the plaintiff would have incurred even if the defendant had performed his contract.

134. *See* note 124 *supra*. Although RESTATEMENT § 349, Comment *a*, points out that "there is no literal rescission of the contract," some courts do speak in terms of rescission. *E.g.*, Seaboard Sur. Co. v. United States, 355 F.2d 139 (9th Cir. 1966).

135. *E.g.*, United States v. Zara Contracting Co., 146 F.2d 606 (2d Cir. 1944); Boomer v. Muir, 74 Cal. App. 435, 24 P.2d 570 (Cal. App. 1933), discussed in Palmer, *supra* note 121, 269-73. Recovery here is limited to the *reasonable* cost of performance, in contrast to the cost of performance under Formula B, in which no limit of reasonableness need be imposed because the profit term has a compensating effect. *See* text accompanying notes 77-79 *supra*.

136. 230 Pa. 480, 79 A. 703 (1911).

137. 230 Pa. at 487, 79 A. at 706. RESTATEMENT § 347, Comment *c*, reads as follows:

> If the plaintiff's performance is part of the very performance for which the defendant bargained as part of an agreed exchange, it is to be valued, not by the extent to which the defendant's total wealth has been increased thereby, but by the amount for which such services and materials as constituted the part performance could have been purchased from one in the plaintiff's position at the time they were rendered. . . . The rate of payment agreed upon in the contract is admissible in evidence on the question of value, but it is not conclusive.

However, the contract price operates as an upper limit where the contract, or some severable part of it, has been fully performed by the injured party, and all that remains to be done by the party in breach is to pay money. *Id.* §§ 350-51.

The argument, of course, overlooks the fact that the measure of Owner's actual benefit from Builder's performance may well be less than the cost to Builder of that performance.[138]

The case for Builder is more appealing where it is unclear whether he would have made a profit or sustained a loss had the contract been fully performed. A court might limit him to nominal damages on the ground that he had not proved damages. But most courts have been more generous to Builder, and there is substantial authority that he may simply ignore the *profit* term in Formula B[139] and recover on the contract itself for his *cost of reliance,* at least so far as it is reasonable.[140] Thus in *United States v. Behan*[141] the Supreme Court of the United States allowed a contractor to recover for his reasonable expenditures, including unavoidable losses on materials on hand, incurred in reliance on a contract which the government ordered stopped. The project was an experimental one in which the contractor was to lay down an artificial covering of cane mats on the bed of the Mississippi River to keep the channel clear for navigation. It did not appear from the evidence whether he would have made a profit or sustained a loss had performance been permitted. According to the Court:

> It does not lie . . . in the mouth of the party, who has voluntarily and wrongfully put an end to the contract, to say that the party injured has not been damaged at least to the amount of what he has been induced fairly and in good faith to lay out and expend (including his own services), after making allowance for the value of materials on hand . . . unless he can show that the expenses of the party injured have been extravagant, and unnecessary for the purposes of carrying out the contract.[142]

The effect is to leave the burden of persuasion as to *profit* on Builder, if he seeks to use *profit* to increase his recovery beyond the *cost of reliance,* but to put the burden as to loss on Owner if he seeks to use loss to reduce Builder's recovery below the *cost of reliance.*[143]

138. *See* the discussion at note 78 *supra.* This may work a kind of rough justice where the contract is a losing one for the reason suggested in note 125 *supra.*

139. Formula B is set out in text at note 77 *supra.*

140. Since the profit term is ignored, a limit of reasonableness must be imposed. *See* note 135 *supra. But see* the criticism of this in Patterson, *supra* note 74, at 1298-99.

141. 110 U.S. 338 (1884).

142. 110 U.S. at 345-46. To the extent that this language suggests that the injured party can recover in full his reasonable outlay, even though the party in breach proves that he would have sustained a loss, it goes too far. *See* L. Hand in L. Albert & Son v. Armstrong Rubber Co., 178 F.2d 182, 189 (2d Cir. 1949).

143. A few courts have allowed pro rata recovery of the contract price, a result that may be justified as a compromise. In Kehoe v. Rutherford, 56 N.J.L. 23, 25, 27 A. 912, 914 (1893), the court allowed the builder "only such a proportion of the contract price as the fair cost of that work bore to the fair cost of the whole work required" for excavation where the contract fixed the price by the cubic yard. In Shapiro Eng'r Corp. v. Francis O. Day Co., 215 Md. 373, 137 A.2d 695 (1958), the court allowed recovery of that amount of the contract price apportioned for the purpose of payment to the part of the contract that had been completed, on the ground that it was "divisible."

Although the *Behan* case was concerned with Builder's recovery under Formula B of the *cost of reliance* where *profit* was in doubt, a similar question arises with respect to Owner's recovery under Formula B′ of the *cost of direct reliance* and the *cost of collateral reliance* where *direct profit* is in doubt.[144] Judge Learned Hand concluded that recovery should be allowed in such a case.

> On principle therefore the proper solution would seem to be that the promisee may recover his outlay in preparation for the performance, subject to the privilege of the promisor to reduce it by as much as he can show that the promisee would have lost, if the contract had been performed.[145]

Indeed, the importance to Owner of this rule allowing him to recover the *cost of direct reliance* and the *cost of collateral reliance* is probably greater than the importance to Builder of the comparable rule allowing him to recover the *cost of reliance,* because Owner will ordinarily have greater difficulty in proving *profit* than will Builder. This can be illustrated by several well-known cases. The earliest is *Nurse v. Barns,*[146] an English case from the seventeenth century, in which an entrepreneur promised to pay £10 to the owner for the use of the latter's iron mills. When the owner denied him their use, the entrepreneur was allowed to recover the £500 that he had lost in stock laid in. The recovery can be viewed as consisting under Formula B, of the *cost of collateral reliance,* there being no *cost of direct reliance,* no *other loss,* and no evidence of *direct profit.*

In *Security Stove & Manufacturing Co. v. American Railway Express Co.,*[147] a frequently cited American case, a manufacturer contracted with a carrier to ship a newly-designed combination oil and gas burner to a trade association convention where it could be exhibited to prospective customers. When the carrier failed to deliver one of the parts, so that the burner could not be exhibited, the manufacturer was allowed to recover its *cost of direct reliance* in the form of the shipping charges plus its *cost of collateral reliance* in

144. Formula B′ is set out in text following note 85 *supra.*

145. L. Albert & Son v. Armstrong Rubber Co., 178 F.2d 182, 189 (2d Cir. 1949). Hand, however, erroneously characterized the reliance as "essential" (*i.e., direct reliance*) when it was "incidental" (*i.e., collateral reliance*). 178 F.2d at 191. *See* note 83 *supra.* RESTATEMENT § 333 provides only for the recovery of expenditures "in performance of the contract or in necessary preparation therefor," which would allow only the cost of *direct reliance* and not the cost of *collateral reliance.* Fuller & Perdue, *supra* note 12 at 89-96, rightly take issue with the *Restatement* on this.

146. Haym. Sir T. 77, 83 Eng. Rep. 43 (1664).

147. 227 Mo. App. 175, 51 S.W.2d 572 (1932). The court asserted that, "There were no profits contemplated." *Id.* at 183, 51 S.W.2d at 577. What it must have meant was that none had been proved. *Cf.* Rabinovitz v. Marcus, 100 Conn. 86, 123 A. 21 (1923), in which the court allowed a purchaser of real property to recover his deposit of earnest money plus his expenses in examining title and preparing papers. The court said that he had chosen to "rescind" the contract and evidently viewed the recovery as based on a combination of the restitution and reliance interests, although it could as well be regarded as being based on the reliance interest alone.

the form of the travel and living expenses of its employees together with an allowance for their salaries and wages, and the rental of the exhibition booth. Here the recovery consisted of both the *cost of direct reliance* and the *cost of collateral reliance,* there being no *other loss* and no proof of *direct profit.*

In *L. Albert & Son v. Armstrong Rubber Co.,*[148] from which the earlier statement by Learned Hand is taken, a manufacturer contracted to buy from a seller, during the Second World War, four machines designed to recondition old rubber. The manufacturer abandoned the venture when the seller failed to deliver the machines in time to be of use. The court allowed the manufacturer to recover the *cost of collateral reliance,* the amount it had expended to lay the foundation for the machines. Again, recovery can be viewed as that under Formula B′ with no proof of *direct profit.* In this case, however, the court allowed the seller the privilege of deducting from the recovery any losses that it could prove the manufacturer would have sustained had the seller delivered the machines on time.

The complexity of the problems that can arise out of such claims for the *cost of collateral reliance* is well illustrated by a 1954 English case, *Cullinane v. British "Rema" Manufacturing Co.*[149] A seller sold to a manufacturer a machine warranted capable of producing six tons of dry clay powder per hour. When delivered and installed it produced only two tons per hour, a rate that made it commercially useless. The manufacturer included in his claim for damages against the seller the amount that he had paid on the purchase price of the machine (the *cost of direct reliance*) and his expenses in the construction of buildings to accommodate the machine (the *cost of collateral reliance*).[150] To this he added the *direct profit* that he had already lost during the first three years of the expected ten-year life of the machine, the period that had elapsed between the delivery of the machine and the trial of the case. In effect, his claim for damages had two parts. One was based on his expectation for the first three years, the period that had passed at the time of the trial and for which he was prepared to prove *direct profit.* He based his calculations of *direct profit* on estimated *collateral income lost* during each year less estimated *cost of complete collateral performance* for that year and less an appropriate amount for depreciation of the machine and buildings for that year. The other part was based on his *cost of reliance* over the remaining seven years of the expected life of the machine, the period that still lay ahead at the time of the trial and for which he was not prepared to prove profits. There is no reason why such a claim should not be honored. Under Formula B′, the manufacturer would be entitled to damages based on the *cost of direct reliance* and the *cost of collateral reliance* plus his entire *direct profit* over the machine's expected life of ten

148. 178 F.2d 182 (2d Cir. 1949).
149. [1954] 1 Q.B.D. 292.
150. To take account of salvage, the manufacturer directed a sum for the "residual value" of the machine and the "break up value" of the buildings. *Id.* at 293.

years. His recovery of the *cost of direct reliance* and the *cost of collateral reliance* should not be prejudiced merely because he limited his claim for recovery based on his expectation of *direct profit* to the first three years of that life, as long as proper account was taken for depreciation during that time. In effect, the manufacturer quite rightly attempted to use Formula B′ in its entirety for the three-year period for which he was prepared to prove profits, and Formula B′ with the *direct profit* term disregarded for the remainder of the ten years, using an appropriate figure for annual depreciation to allocate the proper fraction of the *cost of complete direct performance* and the *cost of complete collateral performance* to the first three years. Unfortunately, the court rejected this attempt. Evershed, M.R., concluded that the manufacturer had to choose between recovery based on "the capital cost he has incurred" and recovery "on the basis of the profit which he has lost,"[151] and accepted the seller's argument that the manufacturer's claim "really involves giving damages twice over."[152] The court limited the manufacturer to the larger of the two items, the direct profit for the three-year period. The case appears to be one in which the court would have benefited from a more careful analysis, along the lines suggested here, of these complex damage problems.[153]

VI. Fifth Choice: Loss or Avoidable Loss?

Up to this point the discussion has focused on the promisee's interest in his bargain. Yet a society that depends so heavily on private bargains has itself a stake in how bargains fare. And although our legal system does not, as we have already seen, generally regard that stake as sufficient to justify it in compelling parties to perform their promises by penalizing them for failure to perform, it does show concern if adequate attempts are not made to avoid unnecessary waste once a bargain miscarries. In order to encourage the injured party to make reasonable efforts to salvage the transaction, it penalizes him, if his efforts are found wanting, by denying him recovery for loss that he could have avoided through reasonable efforts following breach.[154] As a corollary, it compensates him for the cost of such reasonable efforts as he has made.

151. *Id.* at 303.
152. *Id.* at 300.
153. In criticism of the decision, *see* the dissenting opinion by Morris, L.J., at 313; H. Street, Principles of the Law of Damages 243-45 (1919).
154. The word "penalizes" is used advisedly. Since the promisee is ordinarily entitled to recovery based on his actual loss, a rule that denies him recovery for that part of the loss that he could have avoided has the effect of penalizing him for not having avoided it. *But see* Restatement § 336, Comment *d* ("The law does not penalize his inaction"). The promisee who does not avoid the loss is distinguished from the promisee who does, since only the former suffers loss without compensation. In this respect the rule differs significantly from the spurious doctrine of "economic waste," discussed in text accompanying notes 111-118 *supra* in connection with the building contract cases. There the choice of diminution in market price, rather than cost to complete, as a measure of loss in value affords no significant incentive to the owner to avoid any "economic waste" that might be involved in completion, since whichever measure of recovery is chosen, the decision whether to complete or not will turn on whether the owner thinks that it will be "worth what it will cost."

It is, however, misleading to say, as is sometimes done, that the injured party is under a "duty" to mitigate damages.[155] He incurs no liability to the party in breach for his failure to mitigate; in principle his recovery is the same regardless of whether he takes steps in mitigation or not.[156] He is simply precluded from recovering for loss that he could reasonably have avoided. In *Virtue v. Bird*,[157] a quaint illustration from three centuries ago, the plaintiff contracted to carry timber to Ipswich and to deliver it to a place to be appointed by the defendant. When the plaintiff arrived in Ipswich, however, "the defendant delayed by the space of six hours the appointment of the place; insomuch that his horses being so hot . . . and standing in aperto aere, they died soon after."[158] The court denied him recovery of this loss, on the ground that "it was the plaintiff's folly to let the horses stand,"[159] "for the plaintiff might have taken his horses out of the cart, or have laid down the [timber] any where in Ipswich . . . ."[160] Although the avoidable loss in this case took the form of *other loss* in Formula A,[161] the rules concerning mitigation apply equally to *loss on the bargain* and to its two components, *loss in value* and *cost avoided*.[162]

As to *cost avoided*, after a repudiation by the party in breach the injured party is expected to maximize this component in order to minimize his *loss on the bargain* and, therefore, his damages. Ordinarily this means that he is expected to stop work. In *Rockingham County v. Luten Bridge Co.*,[163] a graphic example, a contractor persisted in building a bridge in spite of a repudiation by the other party, a county, directing him not to proceed because it had decided not to build the road of which the bridge was to be a part. The court mused:

> The bridge, built in the midst of the forest, is of no value to the county because of this change in circumstances. . . . [The builder] had no right thus to pile up damages by proceeding with the erection of a useless bridge.[164]

155. In Rock v. Vandine, 106 Kan. 588, 590, 189 P. 157, 158 (1920), the court analyzed mitigation in Hohfeldian terms and concluded that the injured party was under a "legal *disability* to [claim] damages which he might have prevented."

156. If, however, his efforts to mitigate are even more successful than would have been expected, so that he avoids more loss than would have been anticipated, he is limited to his actual loss. *See* text accompanying notes 190-91 *infra*. And if his efforts, although reasonable, are less successful than would have been expected, so that he avoids less loss than would have been anticipated, he is sometimes allowed recovery on his actual loss. *See* text accompanying notes 192-95 *infra*.

157. 3 Keble 766, 84 Eng. Rep. 1000, (same case) 1 Ventris 310, 86 Eng. Rep. 200 (1678). The latter report speaks of "corn" rather than "timber," but a third report, 2 Lev. 196, says "timber."

158. 1 Ventris at 310, 86 Eng. Rep. at 200.

159. *Id.*

160. 3 Keble at 767, 84 Eng. Rep. at 1000.

161. Formula A is set out in text following note 67 *supra*.

162. Where it takes the form of *other loss*, the considerations are much like those encountered in connection with contributory negligence in the law of torts.

163. 35 F.2d 301 (4th Cir. 1929).

164. *Id.* at 307. *See also* Clark v. Marsiglia, 1 Denio (N.Y.) 317, 318-19 (1845), in which the court said:

> To hold that one who employs another to do a piece of work is bound to

To the extent that his obstinacy reduced his *cost avoided* and thereby increased his *loss on the bargain,* the contractor was denied recovery. The Uniform Commercial Code does empower a manufacturer of goods that he has contracted to sell to elect to complete their manufacture in spite of a repudiation by the buyer if "in the exercise of reasonable commercial judgment" the manufacturer concludes that less loss will result from completing the goods and then disposing of them than from halting their manufacture and salvaging them while in process. If he does so he may then base his recovery on the goods as completed, even if his "reasonable commercial judgment" turned out to be in error.[165] Ordinarily, however, the injured party is expected to stop work as a means of maximizing the *cost avoided,* and if he proceeds he does so at his own risk.

As to *loss in value,* the injured party is expected to minimize this component in order to minimize his *loss on the bargain* and, therefore, his damages. Here the "principle of substitution" limits the *loss in value* to him, due to a performance that is not forthcoming, to the cost at which he could replace that performance, with an allowance for any additional loss occasioned by delay in replacement.[166] This is the same principle that makes the cost to complete the upper limit of recovery in the building contract cases,[167] and it is the source of some of the most important of the rules used in calculation of damages. According to this principle, the injured party, on learning of the breach, is expected to take affirmative action to avoid loss by making such substitute

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> suffer it to be done in all events, would sometimes lead to great injustice. A man may hire another to labor for a year, and within the year his situation may be such as to render the work entirely useless to him. The party employed cannot persist in working, though he is entitled to the damages consequent upon his disappointment. So if one hires another to build a house, and subsequent events put it out of his power to pay for it, it is commendable in him to stop the work, and pay for what has been done and the damages sustained by the contractor. He may be under a necessity to change his residence; but upon the [contrary rule], he would be obliged to have a house which he did not need and could not use.

165. UCC § 2-704(2). For a discussion of the seller's options under the Code, *see* Harris, *A Radical Restatement of the Law of Seller's Damages: Sales Act and Commercial Code Results Compared,* 18 STAN. L. REV. 66, 70-72, 100-09 (1965).

166. This, of course, assumes that the situation is among the exceptional ones in which specific relief is available.

167. *See* text accompanying note 89 *supra.* Cost to complete in the building contract cases is one instance of replacement cost, since completion of the building according to specifications involves arranging a substitute transaction with another builder. Of the principle of substitution, Bonbright says:

> Having a house to live in may be so important to me that I would give my entire fortune rather than go without it. But having this particular house is much less important, since I could buy another, equally attractive house, say, for $10,000. Recognition of this principle of substitution has led appraisal writers to lay down the rule that the replacement cost of property ordinarily sets the approximate *upper limit* of its value. . . . Yet this [principle] is not invariably valid, and its universal acceptance would sometimes result in a gross undervaluation. Owners and prospective buyers of property cannot secure substitutes instantaneously; sometimes the delay is serious, not to say fatal. In consequence, property which is now available may be worth much more than the cost of a substitute which would be quite as satisfactory save for the fact that it cannot be secured until a future date.

1 J. BONBRIGHT, *supra* note 62, at 156-57.

arrangements as are reasonable under the circumstances. He is then limited to recovery based on the loss that he would have sustained had such arrangements been made and, as a corollary, is allowed any cost that he has incurred in making such arrangements.[168] The *loss in value* is the difference between the value that performance under the contract would have been to the injured party and the value of the substitute obtained. The *cost avoided* is the cost of that performance less the cost of the substitute. Formula A then becomes Formula C:[169]

(C') *Damages* = [*value of performance* — *value of substitute*] — [*cost of performance* — *cost of substitute*] + *other loss.*

The buyer of goods, for example, on learning of breach by the seller, is expected to attempt to cover by procuring substitute goods from another source. So, in Illustration 2,[170] if upon breach a satisfactory substitute for the replacement part were available for $110, Manufacturer's damages for breach by Supplier would be limited to $10, the additional *cost of substitute* above the contract price of $100 that Manufacturer would have to pay for it, plus any costs of making arrangements to obtain it plus any loss occasioned by the delay in obtaining it.[171] As one nineteenth century court put it:

> Here the plaintiff had his money in his possession and he might have purchased other bacon of the like quality the very day after the contract was broken, and if he has sustained any loss, by neglecting to do so, it is his own fault.[172]

Assuming that the buyer is able to find a fully equivalent substitute, the *loss in value* (represented by the first bracketed term of Formula C) is zero and, since the buyer's *cost of performance* equals the *contract price* and his *cost of substitute* equals the *cover price,* Formula C becomes Formula C-B:

(C-B) *Buyer's damages* = *cover price* — *contract price* + *other loss.*

Exactly what kinds of substitute transactions are reasonable will, of course, depend upon the circumstances.[173] One difficult question arises when buyer has already paid part or all of the purchase price to the seller so that obtaining

168. UCC § 2-713. In practice, however, it is unlikely that the injured party will be compensated in full for the trouble and inconvenience he has been caused by having to make substitute arrangements.

169. Any cost that he has incurred in making the arrangement and any loss that he has sustained as a result of delay in replacement should be included in *other loss.*

170. Illustration 2 is set out in text following note 57 *supra.*

171. UCC § 2-715(2)(a) allows the buyer consequential damages only to the extent that they "could not reasonably be prevented by cover [under UCC § 2-712] or otherwise." *See* UCC § 2-715(1) on incidental damages.

172. Gainsford v. Carroll, 2 B. & C. 624, 625, 107 Eng. Rep. 516 (K.B. 1824).

173. It has been held, for example, that an advertising agency need not "cut its rates for unsold space, with incidental disturbance of its business" to avoid loss. Barron G. Collier, Inc. v. Kindy, 146 Minn. 279, 178 N.W. 584 (1920).

substitute goods will require the buyer to finance a second transaction.[174] Another arises when a buyer has an opportunity to avoid loss by making a less favorable contract with the repudiating seller himself, assuming of course that the buyer is not asked to surrender his rights under the repudiated contract.[175] Rules similar to those governing recipients of goods apply to recipients of, for example, services[176] and land.[177]

Furthermore, supplier, on learning of breach by the recipient, is also expected to arrange a substitute transaction. Thus a seller of goods, on learning of breach by the buyer, is expected to arrange a resale to another buyer.[178] Since the seller is expected to dispose of all of the contract goods, for which he will presumably receive a lower price, his *cost avoided* (represented by the the second bracketed term of Formula C) is zero, and since seller's *value of performance* equals the *contract price* and his *value of substitute* equals the *resale price,* Formula C becomes Formula C-S:

(C-S) *Seller's damages = contract price — resale price + other loss.*

Analogous requirements apply to other suppliers, for example, those of services[179] and land.[180]

That this limitation of recovery, spawned by the principle of substitution, is not an inevitable one can be seen from the fact that at one time it was not applied to the supplier of personal services. In *Gandell v. Pontigny,*[181] an 1816

174. RESTATEMENT § 336, Illustration 10 indicates that he is not expected to finance a second purchase. *See also* T. SEDGWICK, A TREATISE ON THE MEASURE OF DAMAGES § 744 (9th ed. 1912). But the Code makes no such exception to the general rule that bases damages on the assumption that a substitute transaction is possible. UCC § 2-713. *Cf.* UCC § 2-502.

175. The possibility of personal humiliation may also be a factor. *See* Lawrence v. Porter, 63 F. 62 (6th Cir. 1894), for a case in which the court concluded that the buyer should have made the second contract where the seller had breached by refusing to deliver on credit and insisted on cash. *Contra,* Coppola v. Marden, Orth & Hastings Co., 282 Ill. 281, 118 N.E. 499 (1917). The problem is discussed in 5 CORBIN § 1043 and, in connection with the availability of replevin under UCC § 2-716(3), in Peters, *supra* note 131, at 234. An interesting variation occurs when a customer incurs substantial damage by his refusal to pay the unjustified bill of a utility, such as a water company, which has a monopoly on its services. *Compare* Schultz v. Town of Lakeport, 5 Cal. 2d 377, 54 P.2d 1110 (1936), *modified,* 55 P.2d 485 (1936), *with* Severini v. Sutter-Butte Canal Co., 59 Cal. App. 154, 210 P. 49 (1922).

176. *See* 5 CORBIN § 1096. These rules based on the cost of a substitute transaction apply not only to contracts for personal service but also to construction contracts to the extent that *cost of completion* is the measure of recovery applied. *See* text accompanying notes 89-120 *supra.*

177. *See* 5 CORBIN § 1098. As was pointed out in text accompanying note 38 *supra,* the purchaser of land usually can compel specific performance. *See also* the discussion of Flureau v. Thornhill, text accompanying notes 13-16 *supra.* The rule limiting the injured party to recovery based on the cost of a substitute transaction may pinch especially where the broken promise is one to lend money, since whatever the impact on the prospective borrower, recovery is generally limited to the difference between interest at the market rate and interest at the contract rate. *See* 5 CORBIN § 1078.

178. UCC § 2-708.

179. *See* 5 CORBIN § 1095. These rules apply to contracts for personal service. Different rules apply, for example, to construction contracts for the reasons indicated in text accompanying note 208 *infra.*

180. *See* 5 CORBIN § 1098A.

181. 4 Camp. 374, 171 Eng. Rep. 119 (1816).

English case, a merchant was sued by his clerk, whom he had wrongfully discharged in the middle of a quarter. The clerk was allowed to recover the agreed compensation for the entire quarter, including the part when he had not worked, on Lord Ellenborough's reasoning that:

> Having served a part of the quarter and being willing to serve the residue, in contemplation of law he may be considered to have served the whole.[182]

In *Howard v. Daly*,[183] a leading American case decided in 1875, however, this doctrine of "constructive service" was regarded as

> so wholly irreconcilable to that great and beneficient rule of law, that a person discharged from service must not remain idle, but must accept employment elsewhere if offered, that we cannot accept it .... The doctrine of "constructive service" is not only at war with principle but with the rules of political economy, as it encourages idleness and gives compensation to men who fold their arms and decline service, equal to those who perform with willing hands their stipulated amount of labor.[184]

The doctrine has now been replaced by a rule analogous to that applicable to the seller of goods, under which the employee is expected to make reasonable efforts to arrange a substitute transaction by finding similar employment with another employer. His recovery is then determined by what he would have earned under the contract with the party in breach less what he did or could with reasonable efforts have earned elsewhere.[185]

Because ours is a free enterprise economy, there has been a natural tendency to assume that the injured party has available to him a market on which he can arrange a substitute transaction. It is supposed that through the encouragement of substitute transactions on such markets society can avoid waste without relying, as do the communist countries, on a system of generally available specific redress. This supposition is reinforced by the fact that a common purpose of contracting parties in a free enterprise economy is to shift the risk of market fluctuations. In consequence, the substitution principle has

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182. *Id.* at 375, 171 Eng. Rep. at 120.
183. 61 N.Y. 362 (1875).
184. *Id.* at 373.
185. Prima facie the measure of such damage is "the wage that would be payable during the remainder of the term;" but this is only the prima facie measure. The actual damage is measured by the wage that would be payable during the remainder of the term reduced by the income which the discharged employee has earned, will earn, or could with reasonable diligence earn during the unexpired term.

Lehman, J., In Hollwedel v. Duffy-Mott Co., 263 N.Y. 95, 101, 188 N.E. 266, 268 (1933). On the burden of persuasion, *see* text accompanying notes 203-05 *infra*. The employee need not, however, take other employment that is not of the same general character. *E.g.*, Hussey v. Holloway, 217 Mass. 100, 104 N.E. 471 (1914). Courts have disagreed over whether the employee's recovery should be reduced by amounts received as unemployment compensation or similar benefits. *Compare* Pennington v. Whiting Tubular Prod. Inc., 370 Mich. 590, 122 N.W.2d 692 (1963) (not reduced), *with* United Protective Workers v. Ford Motor Co., 223 F.2d 49 (7th Cir. 1955) (reduced).

been generalized to yield the familiar standardized damage formulas. Thus the buyer's damages came to be calculated on the basis of

> the difference between the contract price and the [market] price which the article bore at or about the time when, by the terms of the contract, it ought to have been delivered.[186]

Assuming, then, that the *cover price* is equal to the *market price*, Formula C-B becomes Formula C-B′:

(C-B′) *Buyer's damages = market price — contract price + other loss.*

Buyer's cost of entry into the market along with his loss due to any delay are properly included under *other loss,* although there is a tendency to assume that markets are frictionless and to neglect such additional items as these.[187]

> *Illustration 5.* Seller contracts with Buyer to deliver goods on a specified date for $100,000. Seller fails to deliver on that date. The market price of similar goods at and immediately after the delivery date is $110,000.

Buyer's recovery under the standard damage formula is based on the $10,000 difference between *market price* and *contract price.* Since the objective is compensation of Buyer and not punishment of Seller, this is so even though the the damages that Seller must pay Buyer are compensated for by the enhanced value of the goods to Seller as a result of the rise in their market price. Furthermore, assuming that there is a market on which he can arrange a substitute transaction, Buyer is limited to this recovery even though he might have made a larger profit on resale of the goods.

> *Illustration 5a.* The facts being otherwise as stated in Illustration 5, Buyer, after making his contract with Seller but before Seller's breach, makes a contract to resell the goods to another purchaser for $125,000.

Buyer's recovery is still based on the $10,000 difference between *market price* and *contract price,* and not on the $25,000 gross profit that he would have made on the resale, since it is assumed that by spending only $10,000 more on the market he could obtain goods to enable him to perform his resale contract and realize a gain based on that same resale contract.[188]

Buyer has been allowed damages based on the difference between *market price* and *contract price* even when this gives him a larger recovery than that based on his gross profit on resale.

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186. Gainsford v. Carroll, 2 B. & C. 624, 107 Eng. Rep. 516 (1824).

187. UCC § 2-713(1) allows the buyer "any incidental . . . damages," which are defined in UCC § 2-715(1) to include "any commercially reasonable charges, expenses or commissions in connection with effecting cover," but it is not clear that such charges would be available where the buyer based his recovery on a hypothetical rather than an actual transaction. Any expenses saved by the buyer as a result of the seller's breach should, of course, be included as a negative term in *other loss. See* UCC § 2-713(1).

188. Gross profit is cited as a base because of the ease of illustration. If profit is used as a measure of recovery, of course, adjustment must be made so as to limit the injured party to his net profit. *See* note 201 *infra.*

Illustration 5b. The facts being otherwise as stated in Illustration 5a, the market price of similar goods at and immediately after the delivery date is $130,000.

Buyer may recover damages based on the $30,000 difference between *market price* and *contract price,* although in this instance it exceeds the gross profit that he would have made on the resale, since in order to meet his resale obligation he must pay on the market $30,000 more than the *contract price.*[189]

The goal, however, is still only compensation so that the buyer who covers is limited to his actual loss, and if he is able to cover at a price below the *market price,* he is limited to recovery based on that *cover price.*[190]

189. Brightwater Paper Co. v. Monadnock Paper Mills, 161 F.2d 869 (1st Cir. 1947); Tennessee Fertilizer Co. v. International Agricultural Corp., 146 Tenn. 451, 243 S.W. 81 (1921). *Contra,* Texas Co. v. Pensacola Maritime Corp., 279 F. 19 (5th Cir. 1922); Kaye v. Eddystone Ammunition Corp., 250 F. 654 (E.D. Pa. 1918). The justification for this result is that Buyer will still honor his resale contract, although it is now a losing one, if he has to buy on the market. If, however, Buyer in making his resale contract has protected himself by reserving the power to cancel on breach by Seller, Buyer's loss in value should be based on his loss of profit in the resale transaction. Foss v. Heineman, 144 Wis. 146, 128 N.W. 881 (1910). Here Buyer's situation differs from that where, as in Illustration 5, there is no resale contract because there Buyer might go into the market and buy substitute goods at the enhanced price and still resell them at a profit on his resale market where prices would also be enhanced by the price rise. Here, however, if he goes into the market and buys substitute goods at the enhanced price, he is bound to sell them to his purchaser at his lower resale price, resulting in a greater loss than if he had cancelled, so that arranging a substitute transaction will not avoid loss. This, however, means that Seller can, to the extent of $5,000, benefit by his refusal to deliver the goods to Buyer if he can resell them on the market for $30,000 over the price that Buyer had contracted to pay, and then discharge his liability for breach by paying Buyer only $25,000. (Compare this with Illustration 3g.) To this extent, in effect, he takes advantage of Buyer's power of cancellation. (The alternative, of course, is to allow Buyer to benefit to this extent by exercising his power of cancellation.) With this in mind, the court in *Foss v. Heineman* remarked that there was no "moral unfairness" on the part of Seller, who had delivered all that he could, and that had Seller breached in order to take advantage of the rise in the market, the result might have been otherwise. *See* note 9 *supra. But cf.* Iron Trade Prod. Co. v. Wilkoff Co., 272 Pa. 172, 116 A. 150 (1922) (buyer's damages based on difference between cover price—not resale price—and contract price, and the fact that the purchaser on resale released him was immaterial since, "To hold otherwise would inject collateral issues in trials for breaches of such contracts." *Id.* at 178, 116 A. at 152.) Similar reasoning applies where Seller, after contracting with Buyer, makes commitments with *his* supplier to procure the goods. On Buyer's breach, Seller should be allowed damages based on the difference between the contract price and the price on his resale market, even if this exceeds the profit that he would have made on the transaction, as long as it is assumed that he must still honor his commitment to his supplier. *Cf.* Foglino & Co. v. Webster, 244 N.Y. 516, 155 N.E. 878 (1926) (even though the seller's supplier released him, "the rule to be adopted does not vary because of the generosity of third parties." *Id.* at 518, 155 N.E. at 879); United States v. Burton Coal Co., 273 U.S. 337 (1927) (the seller was not limited to profits although it was not shown that he was bound to take and pay for the goods or that he suffered loss under his agreements with suppliers).

190. UCC § 2-713, Comment 5, which lays down the Code's version of the standard formula for the buyer's recovery based on the difference between market and contract price, asserts that, "The present section provides a remedy which is completely alternative to cover . . . and applies only when and to the extent that the buyer has not covered." The principle that recovery is based on actual loss, even when a market price formula would give a larger amount, also applies to contracts for personal services. Griffin v. Oklahoma Natural Gas Corp., 132 Kan. 843, 297 P. 662 (1931). But for an argument that both buyers and sellers should be allowed recovery based on a hypothetical substitute transaction on the market, even though that recovery exceeds the recovery based on the actual loss, where breach was followed by a more favorable actual substitute transaction, *see* Peters, *supra* note 131, at 259-61.

However, the buyer who does not cover may base his recovery on the market, even

Illustration 5c. The facts being otherwise as stated in Illustration 5, Buyer obtains similar goods for $105,000.

Buyer will be allowed damages based on the $5,000 over the *contract price* that he actually paid and not the $10,000 over the *contract price* that he would have had to pay on the market.[191] If, however, the buyer has arranged cover at a price above the *market price,* he has traditionally been limited to recovery based on *market price,* although his *cover price* might be admitted as evidence of that *market price.*[192]

Illustration 5d. The facts being otherwise as stated in Illustration 5, Buyer obtains similar goods for $115,000.

This sort of discrepancy may occur, for example, when the terms, such as quantity, of the substitute transaction are not identical with those of the original transaction. Courts have in the past limited Buyer to recovery based on the $10,000 difference between *market price* and *contract price,* rather than the $15,000 difference between *cover price* and *contract price.* The Uniform Commercial Code makes a substantial change here by allowing the buyer to base his recovery on a reasonable substitute contract that he actually made rather than the hypothetical one that he might have made on the market. The buyer who reasonably covers by arranging a substitute purchase is given recovery based on the difference between the *cover price* and the *contract price,* or $15,000 in Illustration 5d, together with incidental expenses incurred, such as the cost of his entry into the market, to make the substitute transaction.[193]

though he was wise or lucky in not going into it. Suppose that Buyer's resale contract does not require him to deliver to his purchaser until six months after Seller's breach. Instead of going into the market after the breach and buying at $110,000, he does nothing for six months, by which time the market has dropped to $80,000. His recovery is still based on the $10,000 difference, and he has gained $30,000 by his inaction. Of course if the market had risen further during his delay, he would have lost $20,000 by his inaction. *Cf.* Friedman Iron & Supply Co. v. J.B. Beaird Co., 222 La. 627, 63 So. 2d 144 (1953) (seller retained scrap steel after buyer's breach and market then rose).

191. Illinois Cent. R.R. v. Crail, 281 U.S. 57 (1930), is an interesting illustration of this. A coal dealer claimed damages from a carrier, due to a 5,500 pound shortage in an 88,700 pound carload of coal, and argued that they should be measured by the higher market price for coal sold at retail rather than the lower market price for coal sold in carloads lots. The Supreme Court rejected this argument on the ground that he had in fact purchased no coal to replace the shortage except in carload lots. Mr. Justice Stone wrote,

> This contention ignores the basic principle underlying common law remedies that they shall afford only compensation for the injury suffered . . . . The test of market value is at best but a convenient means of getting at the loss suffered.

Id. at 63-64.

192. The price of cover effected without obtaining quotations from other suppliers was disregarded in Sauer v. McClintic-Marshall Constr. Co., 179 Mich. 618, 146 N.W. 422 (1914). In most instances, however, *cover price* has been accepted as evidence of *market price. E.g.,* Donald W. Lyle, Inc. v. Heidner & Co., 45 Wash. 2d 806, 278 P.2d 650 (1954); King v. D. E. Ryan Co., 179 Minn. 385, 229 N.W. 348 (1930); Growers' Exchange v. John A. Eck Co., 66 Utah 340, 242 P. 391 (1925). But sometimes the price in the substitute transaction has not even been regarded as evidence. *Cf.* Rees v. R.A. Bowers Co., 280 Pa. 474, 124 A. 653 (1924), in which an aggrieved seller of eggs found another buyer after breach and was denied recovery based on that resale price. The court concluded that

> A private resale by a factor in a large, open and available market, of a commodity so universally demanded, is not evidence of market value.

Id. at 482, 124 A. at 656.

193. UCC § 2-712.

Comparable rules apply to the seller, on breach by the buyer.[194] In this case Formula C-S reduces to Formula C-S′:

(C-S′) *Seller's damages = contract price — market price + other loss.*

Under the Code a rule parallel to that on cover by the buyer also protects the seller who arranges a substitute transaction after the buyer's breach, allowing him recovery based on the difference between the *contract price* and the *resale price* if the resale was reasonable.[195]

Permitting the injured party, as the Code does, to base his recovery on terms of reasonable substitute arrangements that he has made may require the court to police the injured party's choice of the substitute arrangements on which he bases his damages. This will be so in any situation in which he regularly makes contracts for similar goods on a fluctuating market, since his tendency in such a situation will be to claim as the substitute that transaction which will yield the largest recovery.[196] The availability of a ready market has, however, the substantial advantage for the injured party of relieving him of the task of establishing *market price*, a task that may raise difficult problems of proof.[197] Therefore, although the injured buyer is not required to cover nor the injured seller to resell, and either can instead claim damages based on *market price*, the use of actual rather than hypothetical substitute arrangements as the basis for recovery has an obvious practical advantage. Although Formulas C-B′ and C-S′ can be extended to transactions not involving goods, such as those involving land or services, there are in these areas no counterparts to the Code's rules allowing the injured party to base recovery on an actual as opposed to a hypothetical substitute transaction.

The principle of substitution has some important restrictions, however, for by its very nature, it applies only where an adequate substitute contract could have been arranged by the injured party. Where no such transaction was possible, the general measure of recovery applies. Thus, the availability of an adequate substitute must be determined by the court and depends on two circumstances.

The first and more obvious circumstance is the accessibility of reasonable opportunities to enter into similar transactions or, in other words, the availability of a market. For when no actual substitute transaction has been arranged, the principle of substitution operates only when there is a market, and in the

194. UCC § 2-708.

195. UCC § 2-706. In the unlikely event that the seller should realize a profit on the resale, he is not accountable to the buyer for it. For further complications, *see* Norstrom, *Seller's Damages Following Resale Under Article Two of the UCC*, 65 MICH. L. REV. 1299 (1967).

196. On the applicable Code provisions, *see* Peters, *supra* note 131, at 256-57.

197. On proof of *market price*, *see* UCC §§ 2-723, 2-724. *See also* UCC § 2-713, Comment 3, which says that "where no market price is available, evidence of spot sales is proper."

absence of a market the general measure of recovery obtains. However, in speaking of "market price," as Lord Dunedin said, "You have always to ask yourself, 'what market.'"[198] Here, the answer is, the market in which the substitute transaction would be arranged. The middleman who buys in one market and sells in another affords a good example. If his seller breaches, the principle of substitution requires that the middleman look to the market in which he buys to find a substitute seller, and *market price* is the price in that market.[199] If his buyer breaches, the principle requires that he look to the market in which he sells to find a substitute buyer, and *market price* is the price in that market. In *Orester v. Dayton Rubber Manufacturing Co.*,[200] the exclusive distributor of the "Dayton pneumatic tire" for the Syracuse area claimed damages from the manufacturer for its refusal to supply the tires he had ordered. The New York Court of Appeals held that it was error to allow recovery based on the difference between the price on the market in which the distributor *sold* and the contract price, for this would allow him his gross profit on resale. It gave these rules for fixing the damages:

> In the case of sales, where the articles may be purchased in the market, the value of the contract to the purchaser is the difference between the price at which in like quantities they may be bought at the time and place of delivery, and the price which he would have to pay under the contract. This rule assumes, however, the possibility of such a purchase on the market. . . . The plaintiff could not purchase tires from others in Syracuse. He himself was the sole source of supply. . . . If there was a market elsewhere at which tires in the quantity desired by the plaintiff could be freely purchased the damages would be the difference between the contract price and the price at that market plus the transportation charges to Syracuse. . . . In the absence of such a foreign market, if the plaintiff might purchase a substitute tire, equally available for his reasonable purposes, then his damages would be the difference between the market price of such substitute and the contract price. . . . Whether another tire, even equally as good, but sold under another trade name, would be a satisfactory substitute to a dealer in Dayton tires, may be at least doubtful. . . . Finally, if none of these tests are practicable another must be adopted. . . . [I]f the other tests fail, he may prove the ordinary and

198. Charrington & Co. v. Wooder, [1914] A.C. 71, 84.

199. *E.g.*, Buyer v. Mercury Technical Cloth & Felt Corp., 301 N.Y. 74, 92 N.E.2d 896 (1950). This situation should be contrasted with that discussed in text accompanying notes 89-120 *supra*, where market price is used as a surrogate for value, because the market price there would be the price that the middleman would realize if he sold the goods on the market, with appropriate deduction for his resale costs. The difference between these two market prices gives the middleman his profit. Where there is merely a delay in performance, so that no substitute contract is feasible, market price is clearly used as a surrogate for value and is therefore the market price which the middleman would realize, not that which he would pay. *E.g.*, Losei Realty Corp. v. City of New York, 254 N.Y. 41, 171 N.E. 899 (1930) (recovery for delay in improving land was measured by the difference in price at which the injured party, the owner, could have rented the land to others with and without improvements); Shepherd, Croan & Co. v. Templeman's Adm'r, 143 Ky. 334, 136 S.W. 648 (1911) (recovery for delay in allowing the buyer of timber to remove it was measured by the difference in the price at which he could have sold it without and with the delay).

200. 228 N.Y. 134, 126 N.E. 510 (1920).

> usual net profits resulting from business conducted in the ordinary and usual way, which he has lost by reason of such breach.[201]

Although it is often said that the place at which *market price* is to be determined is that at which performance was to take place, it is better to say that it is the place at which it is assumed that the injured party will make substitute arrangements, which will often, but not always, be the place of performance. And although it is often said that the time at which *market price* is to be determined is also that at which performance was to take place, it is better to say that it is the time at which it is assumed that the injured party will make substitute arrangements, so that at the very least there should be added a reasonable period for the injured party to make substitute arrangements.[202]

201. *Id.* at 137-39, 126 N.E. at 511-12. UCC § 2-723(2) allows evidence of *market price* at another time or place to be used as a substitute where necessary. And UCC § 2-712 presumably allows the buyer who covers by purchasing on the market at another place, although not at another time ("without unreasonable delay"), to recover the cost of transportation as incidental damages under UCC § 2-715.

202. The UCC provides curiously inconsistent rules for buyers and sellers. Their failings can best be understood if it is assumed that Seller is to tender the goods in Sellersville to an independent carrier, such as a railroad, which will receive them on Buyer's behalf and then transport them to Buyersville, where Buyer himself will then receive and inspect them. If Buyer discovers on inspecting the goods in Buyersville that they are defective and rightfully rejects them, UCC § 2-713 allows him damages measured by

> the difference between the market price at the time when the buyer learned of the breach and the contract price .... Market price is to be determined as of the place for tender or, in cases of rejection after arrival ... as of the place of arrival.

This sensibly assumes that he should arrange a substitute transaction by effecting cover in Buyersville, although it unreasonably supposes that he can do so without delay. If, however, the goods are conforming and Buyer wrongfully rejects them on their arrival in Buyersville, Seller's measure of damages under UCC § 2-708(1) is "the difference between the market price at the time and the place for tender and the unpaid contract price." This is based on the absurd assumption that Seller should have arranged a substitute transaction in Sellersville at the time of his tender to the carrier who received them on Buyer's behalf, even though Buyer's breach did not occur until later. *See* Peters, *supra* note 131, where it is pointed out that this rule is likely to be highly prejudicial to sellers, since buyers are most likely to breach in a falling market. Where the injured party elects to treat an anticipatory repudiation as a breach, under UCC § 2-610, and relies on a market-price formula instead of actually arranging a substitute transaction, the time between breach and tender may be substantial and the discrepancy between the "breach" test for buyer's recovery under UCC § 2-713 and the "tender" test for seller's recovery under UCC § 2-708 will be magnified. The buyer who properly covers is, however, protected under UCC § 2-712, as is the seller who properly resells under UCC § 2-706. For discussion of the complications arising out of anticipatory repudiation under the Code, *see* Peters, *supra* note 131 at 263-67.

If Seller simply fails to deliver to the carrier in Sellersville, Buyer's damages under UCC § 2-713 are to be determined by the *market price* in Sellersville. This is a logical conclusion if it is assumed that Buyer will arrange a substitute transaction on the same market. This assumption was severely tested in Globe Ref. Co. v. Landa Cotton Oil Co., 190 U.S. 540 (1903), in which Buyer, located in Louisville, Kentucky, had incurred expenses to send tank cars to Seller's mill in New Braunfels, Texas, where Seller was to tender crude oil. When Seller failed to deliver, Buyer claimed this expense in addition to damages based on the difference between *market price* at New Braunfels and the *contract price*. Mr. Justice Holmes rejected the claim:

> If it had received the oil these were deductions from any profit which the plaintiff would have made. But if it gets the difference between the contract price and the market price it gets what represents the value of the oil in its hands, and to allow these items in addition would be making the defendants pay twice for the same thing.

Id. at 546. But this reasoning depends on the assumption that the market was such that Buyer could actually have been expected to arrange a substitute purchase in New Braunfels and not elsewhere. See the criticism of this case in Fuller & Perdue, *supra* note 12, at 83.

Since conflicting evidence may be produced as to the availability and terms of opportunities to enter into similar transactions on a market, the burden of persuasion as to these matters is plainly of great practical importance. Where the contract is one for the sale of goods, it is assumed that there is a market, and the burden is on the injured party to show that there was no market available if he seeks to recover profit under the general measure of damages. If he cannot show that, then the burden is on him to show the price at which he could have arranged a substitute transaction on the market.[203] Where the contract is to supply personal services and the breach is by the employee, an analogous rule has been applied.[204] When the breach is by the employer, however, no market is assumed, and the burden is on the employer to show that there was a market if he would limit recovery under the principle of substitution. If he can show that, then the further burden as to the price of a substitute transaction is likewise on him.[205]

The second and more subtle circumstance, bearing on the availability of a substitute for purposes of applying the principle of substitution, is the character of the second transaction, assuming its availability, as truly a *substitute* for the first. Even if there is a market, a transaction arranged on it may not be a substitute, for only if the second transaction would not have been effected but for the breach of the first can it be viewed as a substitute. Here, too, the subject matter of the contract is important. Where the injured party is a supplier of personal services, under a contract of fulltime employment for example, another comparable opportunity is viewed as a substitute since "No man can serve two masters";[206] the employee could not have taken advantage of the opportunity had the original contract not been broken.[207] Where, how-

203. UCC § 2-713 says flatly that the buyer's "measure of damages . . . is the difference between the market price . . . and the contract price . . . ." UCC § 2-708 says that the seller's "measure of damages . . . is the difference between market price . . . and the unpaid contract price . . . ," but if this measure "is inadequate to put the seller in as good a position as performance would have done then the measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance by the buyer . . . ." Courts have been even readier to assume a market for money than for goods. Recovery for breach of a promise to lend money is ordinarily limited to the difference between the contract rate of interest and the market rate of interest, *i.e.*, that at which the aggrieved borrower could get a substitute loan. "There is no other thing so generally dealt in, and so universally prevalent, as money." New York Life Ins. Co. v. Pope, 139 Ky. 567, 571, 68 S.W. 851, 852-53 (1902).

204. Roth v. Speck, 126 A.2d 153 (Mun. Ct. App. D.C. 1956) ("The measure of damages for breach of an employment contract by an employee is the cost of obtaining other services equivalent to that promised and not performed." *Id.* at 155); Triangle Waist Co. v. Todd, 223 N.Y. 27, 119 N.E. 85 (1918); Fugua & Smith v. Massie & Sons, 18 Ky. L. Rptr. 842, 37 S.W. 587 (1896) (burden is on employer to show that no replacement was available).

205. *E.g.*, Levy v. Tharrington, 178 Okla. 276, 62 P.2d 641 (1936). For a minority view, *see* Abrams v. Jackson County Bd. of Educ., 230 Ky. 151, 18 S.W.2d 1000 (1929). The problem does not ordinarily arise where the injured party is a supplier of services that are not personal, for the reasons indicated at note 209 *infra*. For the related problem of allocating the burden of persuasion as to *cost avoided* in contracts for services that are not personal, *see* note 68 *supra*.

206. *Matthew* 6:24.

207. *See* note 185 *supra*.

ever, the injured party is a supplier of services that are not personal, under a contract for construction of a building for example, another comparable opportunity is not viewed as a substitute. Rather, it is assumed that the contractor could have expanded his business to undertake additional jobs so that the breach of the original contract resulted in "lost volume" that could not be recaptured by a second similar contract.[208] Even if it can be proved that there was a market on which other similar opportunities were available, the principle of substitution would not apply and the general measure of recovery would obtain. And even if the contractor actually enters into another similar transaction after breach, it is assumed that he would have done so anyway and it is not regarded as a substitute.[209]

This second aspect is of particular importance in connection with contracts for the sale of goods because of the assumption in such cases that there is a market. Yet even if there is a market, where the injured party is a seller whose supply exceeds his demand, a second sale of the same goods on that market will not recapture his profits, for it will cost him a sale of other goods that he would otherwise have sold.[210] Where the injured party is a manufacturer who has contracted to sell goods that he produces, this assumption is ordinarily made, the manufacturer being treated like the building contractor and allowed to recover under the general measure of recovery and without regard to the principle of substitution.[211] In spite of the existence of a market, the manufacturer is thus allowed to recover for his lost volume, since the assumption is that his supply is at least equal to his demand and that he has, therefore, lost a sale if he is obliged to sell the same goods twice.

> *Illustration 6.* Manufacturer contracts with Buyer to produce and deliver goods to Buyer for $100,000, the market price of the goods at

208. *E.g.*, Mount Pleasant Stable Co. v. Steinberg, 238 Mass. 567, 131 N.E. 295 (1921). On the problem of overhead saved in such a case, *see* note 73 *supra.*

209. This is true even if the other transaction is one which would not have been available to him but for the breach. In Olds v. Mapes-Reeve Constr. Co., 177 Mass. 41, 58 N.E. 478 (1900), a subcontractor, after breach by the contractor, made a second contract directly with the owner to do substantially the same work called for by the first contract, and the court held that it was error to base the subcontractor's recovery against the contractor on the difference between the price in the first contract with the contractor and the price in the second contract with the owner. *Accord,* Kunkle v. Jeffe, 71 N.E.2d 298 (Ohio Ct. App. 1946) (a real estate broker, after the vendor breached by failing to sell to a puchaser procured by the broker, arranged the sale of other property to the same purchaser at an even larger commission); Grinnell Co. v. Voorhies, 1 F.2d 693 (3d Cir.), *cert. denied,* 266 U.S. 629 (1924) (a contractor who had agreed with the owner to install an automatic sprinkler system, after the owner became insolvent and breached, made a similar contract with the firm that took over the insolvent owner's premises).

210. The same holds true where the injured party is a buyer whose demand exceeds his supply, a circumstance that may be occasioned by wartime shortages, for example. Cover will not recapture the buyer's profits, for it will require him to purchase goods that he would otherwise have purchased anyway for another transaction. Although UCC § 2-713 on buyer's damages contains no provision allowing profits comparable to that in UCC § 2-708 on seller's damages, it was held before the Code that buyer could claim profits in such a case. Norwood Lumber Co. v. McKean, 153 F.2d 753 (3d Cir 1946).

211. *See* Oswego Falls Pulp & Paper Co. v. Stekher Lithographic Co., 215 N.Y. 98, 109 N.E. 92 (1915); Allegheny Iron Co. v. Teaford, 96 Va. 372, 31 S.E. 525 (1898); Hinckley v. Pittsburgh Steel Co., 121 U.S. 264 (1887).

> the time of the contract. By the time for delivery the market price of the goods has fallen to $80,000 and Buyer wrongfully rejects them. It cost Manufacturer $70,000 to produce them, but because of a drop in the cost of production that parallels the drop in the market price of the goods, it would cost him only $60,000 to produce them if he began at the time of the Buyer's rejection. Manufacturer sues Buyer for damages.

Regardless of the availability of a market on which Manufacturer could sell the goods, he is not limited to the $20,000 difference between the contract price and the price that he would have realized had he resold the goods on the market, for it assumed that by reselling these goods he would have lost a sale of other goods that he would otherwise have arranged. He is allowed damages under the general measure of recovery of Formula A.[212] The problem is not as simple as that in Illustration 3a,[213] however, for there a completed building was involved, which had to be left on the premises of Owner, the party in breach. Here, after rejection, the goods are in the hands of Manufacturer so that in applying Formula A there must be subtracted from the $100,000 *loss in value*, a sum as *cost avoided* that is equal to the value of the unsold goods to Manufacturer. That sum is not the $80,000 market price, because a sale on the market at that price would cause the loss of another sale; it is not the $70,000 actual cost, since if he were to produce them now he could do so for less; it is rather the $60,000 reduced cost of production that would apply to a new order arranged within a reasonable time after rejection, since it is this amount that he could presumably save by adjusting his production as of that time to make use of the rejected goods. His recovery is then based on the difference between the $100,000 *loss in value* and the $60,000 *cost avoided*, or $40,000,[214] of which $30,000 can be attributed to the loss in volume and would have been recoverable had there been no change in the market, and $10,000 can be attributed to the market drop as reflected in the reduced cost of production.

Courts have not been so liberal where the injured party is a middleman whose buyer has breached a contract for the sale of goods that the middleman has bought from another. The middleman is generally treated like the employee under a personal service contract and is remitted to damages based on the difference between *contract price* and *market price*, with no allowance for lost volume. The assumption is that his demand exceeds his supply and that therefore he has not lost a sale if he is obliged to sell the same goods twice.[215]

> *Illustration 6a.* Jobber contracts with Buyer to deliver goods to Buyer for $100,000, the market price of the goods at the time of the contract. By the time for delivery the market price of the goods has

212. Formula A is set out in text following note 67 *supra*.
213. Illustration 3a is set out in text following note 71 *supra*.
214. *See* Comment, *Remedies for Total Breach of Contract Under the Uniform Revised Sales Act*, 57 YALE L.J. 1360, 1373 (1948).
215. *E.g.*, Charles Street Garage Co. v. Kaplan, 312 Mass. 624, 45 N.E.2d 928 (1942).

fallen to $80,000 and the Buyer wrongfully rejects them. It cost Jobber $70,000 to acquire and deliver them, but because of a drop in the market on which Jobber acquires goods that parallels the drop on the market in which he sells them, it would now cost him only $60,000 to fill new orders. Jobber sues Buyer for damages.

Regardless of whether Jobber's demand does or does not exceed his supply, he is generally limited to recovery based on the $20,000 difference between *contract price* and *market price* on the assumption that a sale on the market would not result in a loss of volume and is, in fact, a substitute sale. Should this not be the case, his actual loss would be the difference between $100,000 and $60,000, or $40,000, so that recovery based on market price would here compensate him only to the extent of half of that actual loss. Courts have traditionally, however, been reluctant to allow middlemen to recover damages based on lost volume, even when, as in the case of an item with standard price, there is no market fluctuation so that damages based solely on the difference between *contract price* and *market price* are purely nominal.[216] The extent to which the Uniform Commercial Code will encourage courts to allow recovery for lost volume is unclear.[217]

Where the principle of substitution applies, it has the major consequence of relieving the court of much of the burden of calculating loss. As long as it is supposed that the injured party can procure a satisfactory substitute, which along with an appropriate allowance for any resulting delay and expense will put him in the position in which he would have been had the promise been performed, the court can avoid what might be a difficult inquiry into the difference between the value to the injured party of the position he bargained for and the value to him of the position in which he found himself following breach. And when there is added a readiness to assume that markets are available on which such substitute transactions can be arranged, the result is a further depersonalization through the development of the standard damage formulas. If, in Illustration 2[218] for example, it is assumed that the market price of substitute

216. For an extensive discussion of the lost volume problem, *see* Harris, *supra* note 73, at 599-605; Harris, *A Radical Restatement of the Law of Seller's Damages: Michigan Results Compared*, 61 MICH. L. REV. 849, 906-10, 918-19 (1963). Exceptional cases in which a middleman has been allowed to show lost volume include Locks v. Wade, 36 N.J. Super. 128, 114 A.2d 875 (1955) (lease of a juke box of which the lessor had an unlimited supply); Smead v. Sutherland, 118 Vt. 361, 111 A.2d 335 (1955) (sale of a "Henry J. Vagabond," a car not readily marketable); Wilhelm Lubrication Co. v. Brattrud, 197 Minn. 626, 268 N.W. 634 (1936) (sale of grease in a "highly competitive market").

217. The Code provisions are discussed in Harris, *supra* note 165, at 94-99, and the author concludes that "while it is easy to reach bad results under section 2-708, it is not absolutely necessary." *Id.* at 101. Comment 2 to that section says that it "permits the recovery of lost profits in all appropriate cases, which would include all standard priced goods." This confuses standard price, which should not be determinative, with lost volume, which should. Furthermore, even if UCC § 2-708(2) is applied to illustration 6(a) in spite of the fact that the goods are not standard priced, it allows only damages based on the "profit . . . which the seller would have made from full performance by the buyer" and thus would appear to limit him to $30,000, the difference between $100,000 and $70,000, and not his full loss of $40,000, the difference between $100,000 and $60,000. In short, the draftsmen evidently did not address themselves to problems of lost volume in a fluctuating market.

218. Illustration 2 is set out in text following note 57 *supra*.

replacement part is $110, Buyer's damages can be based on $10 and any inquiry into the value of the part to him personally can be avoided. Where the principle of substitution cannot be applied, however, calculation of recovery will often be complicated by factors that are peculiar to the particular circumstances of the injured party. It is here that questions of foreseeability and certainty arise.

VII. Sixth Choice: Loss or Foreseeable Loss?

As was observed earlier, one of the handicaps that attends a system of contract damages aimed at protecting expectations is that it requires a hypothesis of the position in which the injured party would have found himself had both parties performed. It is that hypothetical position that determines the *loss in value,* and consequently the *loss on the bargain,* that resulted from the breach. Although the determination of contract damages, and particularly of *other loss,* may involve the same problems of multiple cause[219] and intervening cause[220] that enliven discussions of torts, they are of relatively less importance than the problems of causation that are involved in the hypothesis required to fix the *loss in value.*[221]

Even this aspect of causation, however, is often rendered academic by the additional and more stringent requirement that the loss must have been foreseeable by the party in breach at the time he made the contract.[222] This means that the court must put itself in the position of that party at that earlier time and imagine what he could have foreseen with regard to the other party's position in the event of full performance. Since the calculation of *loss in value* is based on the court's later hypothesis in this regard, foreseeability and not causation ordinarily marks the effective limit of liability for breach of contract.

This requirement of foreseeability grew out of a realization that even where the injured party has taken such steps as the law expects to avoid loss, a rule allowing full compensation might impose on the party in breach a crushing burden, greatly out of proportion to the benefit that he originally expected to

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219. *E.g.,* Krauss v. Greenbarg, 137 F.2d 569 (3d Cir. 1943).

> If a number of factors are operating one may so predominate in bringing about the harm as to make the effect produced by others so negligible that they cannot be considered substantial factors and hence legal causes of the harm produced.

Id. at 572 (Goodrich, J.).

220. *E.g.,* Newsome v. Western Union Tel. Co., 153 N.C. 153, 69 S.E. 10 (1910), discussed at text accompanying note 260 *infra;* Nirdlinger v. American Dist. Tel. Co., 245 Pa. 453, 91 A. 883 (1914) (failure of burglar alarm system, which the defendant had contracted to maintain, "did not cause the burglary"). Such cases usually, however, turn on the issue of foreseeability rather than causation. *See also* note 252 *infra.*

221. For the peculiar difficulties posed in determining the *loss in value* where the party in breach could have rendered alternative promises, *see* Restatement § 344; 5 Corbin § 1079; 11 S. Williston & W. Jaeger, A Treatise on the Law of Contracts § 1407 (3d ed. 1961).

222. Another reason why causation tends to play a lesser role in contract than in tort is the higher standard of certainty in the latter, which also tends to make the issue of causation academic. Furthermore, although the issue of causation is an essential part of a tort action in negligence, nominal damages may be awarded for breach of contract without regard to the element of causation.

derive from his bargain. This is particularly true of compensation for loss of collateral profits. As Hart and Honoré have pointed out:

> The need for limitation is especially clear in regard to compensation for loss of economic stipulated opportunities, since the provision of opportunities for gain may have a snowball effect: opportunities breed further opportunities.[223]

If, in Illustration 2,[224] Manufacturer is unable to obtain a substitute replacement part for a month following Supplier's breach, does it follow that he can recover from Supplier his loss of profits during that period of delay? This was the issue raised in the famous English case of *Hadley v. Baxendale*,[225] which in 1864, as the culmination of nineteenth-century attempts to reach a workable generalization on contract damages, laid down general principles that have endured until today. That case involved a miller's claim against a carrier for loss of profits during a period when his steam grist-mill was shut down due to the carrier's delay in delivering the broken crankshaft of the steam engine to its manufacturer for duplication and replacement. According to Baron Alderson's now familiar statement,

> the damages . . . should be such as may fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract as the probable result of the breach of it.[226]

Applying these principles, the court granted the carrier's motion for a new trial on the ground that it was error to have held it liable for the loss of profits of the miller, who had communicated only the circumstances "that the article to be carried was the broken shaft of a mill, and that the plaintiffs were the millers of that mill."[227] For all the carrier knew the miller might have had a spare crank shaft as a replacement or the machinery might have been defective in other respects, so that the carrier's delay would have had no effect upon the profits of the mill.

Subsequent gloss on the case has given rise to two rules. Under the "first rule" the party in breach is liable for loss "arising naturally, i.e. according to the

223. H. Hart & A. Honoré, Causation in the Law 281 (1959). *Cf.* F. Bacon, Maxims of the Law 1 (1936):

> It were infinite for the law to judge the causes of causes, and their impulsions one of another, therefore it contenteth itself with the immediate cause, and judgeth the acts by that, without looking to any further degree.

224. Illustration 2 is set out in text following note 57 *supra.*

225. 9 Ex. 341, 156 Eng. Rep. 145 (1854).

226. *Id.* at 354, 156 Eng. Rep. at 151.

227. *Id.* at 355, 156 Eng. Rep. at 151. The facts of *Hadley v. Baxendale* are not entirely clear. The head-note states, among the facts that "appeared" at the trial below, that, "The plaintiffs' servant told the clerk that the mill was stopped, and that the shaft must be sent immediately." *Id.* at 344, 156 Eng. Rep. at 147. And yet "it is reasonably plain from Alderson B's judgment that the court rejected this evidence," as the court pointed out in Victoria Laundry (Windsor) Ltd. v. Newman Indus. Ltd., [1949] 2 K.B. 528, 537.

usual course of things, from such breach of contract itself."[228] Under the "second rule" he is liable for such loss "as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it."[229] Damages recoverable under the second rule have sometimes been described as "consequential" or "special" to distinguish them from damages recoverable under the first, which are termed "direct" or "general." The use of the terms "general" and "special" is unfortunate, however, since they originated in, and are still properly applied to, the distinction between those losses that are so usual that they need not be specifically set out in the pleadings and those that are so unusual that they must be so set out.[230] Since it is best not to confuse problems of substantive liability with those of pleading by employing the same terminology for both, it is better to use the terms "direct" and "consequential."[231]

That portion of Baron Alderson's dictum described as the "first rule" has occasioned little controversy. In the typical case, the losses "arising naturally," and therefore recoverable under that rule, are those afforded under the standard formulas based on *market price* and discussed earlier. This is so because losses due to market shifts are classed among those "arising naturally," although as Bonbright remarked:

> Some of the most extraordinary and most unpredictable losses resulting from breaches of contract are those due to unusual changes in market price. On the other hand, one of the most "normal" and most predictable types of loss resulting from a breach is the "incidental expense" or loss of sales imposed upon a businessman by a failure to receive a shipment of goods on *the promised date of delivery*.[232]

In Illustration 2, for example, the "first rule," in the form of Formula C-B′[233] using *market price*, is ordinarily applied on the assumption that Manufacturer can find a substitute for the replacement part promised him by Supplier, even though he may have to pay a higher price. If Manufacturer disputes this assumption and claims damages for lost profits, he must bring himself within the "second rule."

It is this branch of *Hadley v. Baxendale* that has been significant. By confining damages, other than those arising "naturally," to those "in the contemplation of the parties, at the time they made the contract, as the probable result of the breach of it," the courts in following the rule imposed an important new

228. 9 Ex. 354, 156 Eng. Rep. 151.
229. *Id.*
230. *See* McCormick § 8. *See, e.g.*, Fed. R. Civ. P. 9(g).
231. *See* UCC § 2-715 which speaks of "consequential damages." *See also* 5 Corbin § 1011.
232. 1 J. Bonbright, *supra* note 62 at 291. *Cf.* B.P. Ducas Co. v. Bayer Co., 163 N.Y.S. 32 (Sup. Ct. 1916) (failure of supply and sharp rise in prices, caused by embargo when war broke out, were not "contemplated" at time of contract). It should be kept in mind, however, that protection of the parties against shifts in the market is considered in our society to be a principal function of the institution of contract.
233. Formula C-B′ is set out in text following 186 *supra*.

limitation on the scope of recovery that the jury could allow. The restriction was not unheralded. Courts during the eighteenth century had, for example, limited recovery for breach of a promise to pay money to the principal sum with interest, for in such a case, as Sedgwick wrote in the decade before *Hadley v. Baxendale*, "it is well settled that the consequences of the nonperformance cannot be inquired into any way."[234] Even the test of "contemplation" was not an original one and showed, among other influences, that of French law.[235]

In the course of his opinion, Baron Alderson suggested that, "had the special circumstances been known, the parties might have specially provided for the breach of contract by special terms."[236] Some of the cases that followed picked up this dictum and read into the "contemplation" test a requirement of "tacit assumption." In *Globe Refining Co. v. Landa Cotton Oil Co.*,[237] Justice Holmes declared that

> the extent of liability . . . should be worked out on terms which it fairly may be presumed he would have assented to if they had been presented to his mind. . . . [It] depends on what liability the defendant fairly may be supposed to have assumed consciously, or to have warranted the plaintiff reasonably to suppose that it assumed, when the contract was made. . . . [M]ere notice to a seller of some interest or probable action of the buyer is not enough.[238]

The trend has now, however, gone the other way. The Restatement's formulation of the rule states merely that

> compensation is given for only those injuries that the defendant had

234. T. SEDGWICK, *supra* note 56, at 111.

235. Pothier gives the example of

> a canon, who for want of having the horse that I had engaged to deliver to him, and not having been enabled to get another, was prevented from arriving at the place of his benefice in time to be entitled to his revenue; I should not be liable for the loss which he sustained thereby, although it was occasioned by the non-performance of my obligation; for this is a damage which is foreign to the obligation, which was not contemplated at the time of the contract, and to which it cannot be supposed that I had any intention to submit.

R. POTHIER, THE LAW OF OBLIGATIONS 91-92 (W. Evans trans. 1806). *See generally*, Washington, *supra* note 57, at 97-108.

236. 9 Ex. at 355, 156 Eng. Rep. at 151.

237. 190 U.S. 540 (1903).

238. *Id.* at 543-45. *See also* British Columbia Saw Mill Co. v. Nettleship, L.R. 3 C.P. 499 (1868), on which Holmes relied in part. There Bovill, C.J., said that the liability "must be something . . . to which he has assented expressly or impliedly by entering into the contract." *Id.* at 506. And Willes, J., added that if the liability claimed "had been presented to the mind of the ship-owner at the time of making the contract, as the basis upon which he was contracting, he would at once have rejected it." *Id.* at 508. Holmes had already stated his view in O. HOLMES, THE COMMON LAW 302-03 (1881):

> It is true that, when people make contracts, they usually contemplate the performance rather than the breach. . . . [But] as the relation of contractor and contractee is voluntary, the consequences attaching to the relation must be voluntary. What the event contemplated by the promise is, or in other words what will amount to a breach of contract, is a matter of interpretation and construction. What consequences of the breach are assumed is more remotely, in like manner, a matter of construction, having regard to the circumstances under which the contract is made.

> reason to foresee as a probable result of his breach when the contract was made.[239]

Similarly the Uniform Commercial Code allows the buyer

> [C]onsequential damages . . . [for] any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know . . . .[240]

The prevailing test is most commonly expressed as one of "foreseeability" of probable consequences.[241]

Concerning this obviously vague criterion, a few things can be said with some assurance. One is that since the foreseeability of probable consequences is to be determined as of the time of the making of the contract, it is unaffected by events subsequent to that time.[242] Another is that, although Baron Alderson spoke of "the contemplation of both parties," the Restatement and the Code speak of foreseeability by the party in breach alone.[243] And a third is that this foreseeability has an objective character: a contracting party takes the risk not only of those consequences which he actually thought were probable, but also of those consequences which he—or a reasonable man in his place—*should* have thought were probable.[244]

Beyond this it is difficult to speak with precision. It has, for example, been argued by Fuller and Perdue that the requirement of foreseeability does not

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239. RESTATEMENT § 330. It goes on to say:

> If the injury is one that follows the breach in the usual course of events, there is sufficient reason for the defendant to foresee it; otherwise, it must be shown specifically that the defendant had reason to know the facts and to foresee the injury.

Both of Baron Alderson's rules are therefore comprehended under the single test of foreseeability. The tendency to speak of two rules persists nonetheless.

240. UCC § 2-715(2)(a). Where, however, the buyer sues for breach in regard to accepted goods, UCC § 2-714(1) allows him "the loss resulting in the ordinary course of events from the seller's breach," and where he sues for breach of warranty, UCC § 2-715 (2)(b) allows him to recover for "injury to person or property proximately resulting from" the breach.

241. *See* UCC § 2-715, Comments 2, 3.

242. *See* authorities quoted in text at notes 239, 240 *supra*. *See also* 5 CORBIN § 1008.

243. *See* quotations in text at notes 239, 240 *supra*. *See also* 5 CORBIN § 1010.

244. *See* authorities quoted in text at notes 239, 240 *supra*. *See also* 5 CORBIN § 1009. One of the leading restatements of the rule came in Victoria Laundry (Windsor) Ltd. v. Newman Indus. Ltd., [1949] 2 K.B. 528, 539:

> In cases of breach of contract, the aggrieved party is only entitled to recover such part of the loss actually resulting as was at the time of the contract reasonably foreseeable as liable to result from the breach.
>
> What was at that time reasonably so foreseeable depends on the knowledge then possessed by the parties or, at all events, by the party who later commits the breach.
>
> For this purpose knowledge "possessed" is of two kinds; one imputed, the other actual. Everyone, as a reasonable person, is taken to know the "ordinary course of things" and consequently what loss is liable to result from a breach of contract in that ordinary course. . . . But to this knowledge . . . there may have to to be added in a particular case knowledge which he actually possesses, of special circumstances outside the "ordinary course of things," of such a kind that a breach in those special circumstances would be liable to cause more loss.

apply to the *cost of direct reliance* but only to *collateral reliance*,[245] and by Hart and Honoré that it does not apply to *other loss* but only to *loss on the bargain*.[246] But the central question remains, with what degree of clarity and with what probability must the actual loss have been foreseeable? Although the requirement neither demands absolute clairvoyance nor admits of vague premonition, it leaves considerable latitude between these extremes.

In *Czarnikow-Rionda Co. v. Federal Sugar Refining Co.*,[247] Federal contracted to sell 75,000 tons of sugar to Czarnikow to be delivered directly to Czarnikow's customers. Czarnikow in turn made contracts with its customers for the sale to them of sugar described as "Federal" brand. When the sugar delivered by Federal turned out to be defective, Czarnikow spent $340,000 in the settlement of claims and the defense of law suits brought by its customers. The New York Court of Appeals reversed a judgment for Czarnikow allowing recovery for this loss and granted a new trial. Liability for the special loss incurred by Czarnikow could be visited on Federal

> only if it "knew that other goods of the kind contracted for could not be obtained by the buyer." . . . [I]f the circumstance that Czarnikow sold sugar specified to be "Federal Sugar Refining Co. brand" entered in to swell the damage suffered by it, that circumstance could not have been foreseen by Federal when contracting, and for the special consequence resulting therefrom it should not be liable.[248]

245. So far as essential [direct] reliance is concerned, there is usually no occasion to deny reimbursement for "remote" items, and the problem of *Hadley v. Baxendale* does not normally give any difficulty. Applying the test of foreseeability, one would not hesitate to say that the defaulter should have foreseen that the plaintiff would undertake those acts necessary to perfect his rights on the contract. Furthermore, the limitation of recovery by the full contract price is a limitation sufficiently drastic to dispense with the need for any other device for reducing recovery. Fuller & Perdue, *supra* note 12, at 87-88. *But see* Rochester Lantern Co. v. Stiles & Parker Press Co., 135 N.Y. 209, 31 N.E. 1018 (1892), in which the plaintiff, who planned to begin manufacturing lanterns, rented a room and paid employees in reliance on the defendant's promise to furnish the dies for the lanterns, only to be denied recovery for these expenses on the ground that they were not contemplated since it could, at the most, have been expected that the plaintiff would have had to pay more to obtain other dies.

246. H. Hart & A. Honoré, *supra* note 223, at 287:

> Where compensation is sought from a defendant who has failed to provide a stipulated opportunity for gain, liability must necessarily be assessed by reference to hypothetical gains, and it is reasonable to limit these to gains which would be made in circumstances likely to occur or contemplated by the parties. Where however, physical harm, etc., which would not have occurred without defendant's earlier wrongful act has actually occurred, the question whether liability should extend to it is more reasonably determined by considering not hypothetical events but the character of the intervening events and circumstances.
>
> Yet it cannot be said that the distinction we have urged between these two types of problems is recognized in the case . . . .

The requirement of foreseeability ought not, however, be applied to bar unforeseeable windfalls to the party in breach. For example, if an aggrieved buyer spent $10,000 in reliance on the contract before a sudden turn of events showed he would have *lost* $5,000 had the contract been performed, the $5,000 should be subtracted from the $10,000 even though his loss was not foreseeable. Otherwise the buyer will get more than his expectancy. *See* quotation in text at note 145 *supra*.

247. 255 N.Y. 33, 173 N.E. 913 (1930).

248. *Id.* at 46-47, 173 N.E. at 917. *Cf.* UCC § 2-715(2)(a), quoted in text at note 240 *supra*, and Comment 3 ("Particular needs of the buyer must generally be made known to the seller. . . .").

Two judges dissented. Federal knew, they argued, that the sugar was destined for resale by Czarnikow.

> I do not understand the law to be that before a seller is liable for loss of profits, he must have known the terms and conditions of the subcontracts made on resale by his purchaser. That Federal did not know the price or the terms of the contracts which Czarnikow had made with its consignees of the sugar was for the purpose of this action immaterial.[249]

Similar controversies may arise where there are claims for profits based on an abnormal use of the goods[250] or an unusually profitable subcontract,[251] or for losses due to the occurrence of an unexpected intervening event[252] or a peculiar penalty provision in a subcontract.[253] The extent to which each of these must be specifically foreseeable under the test of *Hadley v. Baxendale* is a matter on which courts have disagreed.

Equally troublesome has been the substantial claim for a foreseeable loss of profits against a promisor whose undertaking was in return for a relatively insignificant fee. In the typical case the injured party's *loss in value* greatly exceeds the benefit that the party in breach was to have received in return. Indeed, had the miller in *Hadley v. Baxendale* made his situation known to the carrier when he gave him the broken shaft, the court would have been faced with such a case and would, on its own dictum, have had to allow the miller's claim.[254] Many of the most notable examples of such cases have involved undertakings by carriers to deliver goods,[255] by telegraph companies to transmit messages,[256]

249. *Id.* at 53-54, 173 N.E. at 920.

250. *E.g.*, Cory v. Thames Ironworks Co., [1868] 3 Q.B. 181 (hull of floating boom derrick intended for novel use, to contain machinery, rather than ordinary use, to store coal).

251. *E.g.*, Macchia v. Megow, 355 Pa. 565, 50 A.2d 314 (1947) (seller's default in delivery caused cancellation of buyer's resale contract with the government).

252. *E.g.*, Coppola v. Kraushaar, 102 App. Div. 306, 92 N.Y.S. 436 (1905) (delay in delivery of wedding gowns caused cancellation of wedding); Otter v. Church, Adams, Tatham & Co., [1953] 1 All E.R. 168 (bad advice by solicitor prevented client from disentailing property before he was killed in war). *See also* note 220 *supra*. A particularly troublesome situation arises when the loss in value turns out to be greater than might have been anticipated for the reason that the value of the performance promised by the party in breach has turned out to be greater than was at first supposed. Bonbright uses the term "hindsight" value in discussing such situations, as, for example, that of the man who contracts to buy land which turns out to be rich in oil. 1 J. Bonbright, *supra* note 62, at 82-84. As for the man who contracts to buy what he thinks is oil-rich land and discovers, before the other party's breach, that it contains no oil, *see* note 246 *supra*.

253. *See* Krauss v. Greenbarg, 137 F.2d 569 (3d Cir. 1943) (delay in delivery of webbing resulted in imposition on buyer of penalties under his resale contract with the government).

254. Excerpt from the court's opinion in *Hadley v. Baxendale* quoted at text accompanying note 226 *supra*. *But see* Harper Furniture Co. v. Southern Express Co., 148 N.C. 87, 62 S.E. 145 (1908) (carrier liable for closing of mills during delay in delivery of shaft, but damages based on interest on invested capital and pay of idle employees rather than lost profits).

255. *Hadley v. Baxendale* is itself an example.

256. *E.g.*, Kerr S.S. Co. v. Radio Corp. of America, 245 N.Y 284, 157 N.E. 140 (1927), discussed in note 261 *infra*.

and by financial institutions to lend money.[257] But these are by no means the only instances in which courts have shown a reluctance to impose upon a promisor a loss which, although foreseeable, is greatly out of proportion to the benefit that he received in return for his promise. In a case with facts very similar to those of Illustration 2, the Arkansas Supreme Court relied upon the gross disproportion between the damages claimed and the benefit received in denying recovery for lost profits.[258]

> Suppose, for instance, that a large manufacturing establishment is driven by power from a single engine, and that, by reason of an accident to some small but important part of the engine or machinery, it becomes necessary to stop the operation of the whole plant until a new part can be made or the old one repaired. If thereupon a blacksmith or machinist is called in, and for the price of a few dollars undertakes to make the repairs, but, through some mistake or unskillfulness, the part supplied by him should fail to fit, requiring it to be remade, and entailing still further delay, would any court hold that the blacksmith or machinist could be held liable for all the damages entailed by the delay, when they were large, in the absence of a contract on his part to be thus liable, unless the notice and the circumstances under which he made the contract were such that he ought reasonably to have known that in the event of his failure to perform his contract the other party would look to him to make good the loss?[259]

Often a court in such a situation can find grounds to deny recovery under one of the other limitations, such as the requirement of certainty or that of causation itself. A colorful example involved the lumberman who wired for four gallons of whiskey, informing the telegraph operator that he required it for his raft hands who would not make the trip downstream without it. Because the transmission was garbled, the whiskey was not sent, the raft hands refused to take the raft, the river subsided, and the lumberman sued the telegraph company for damages based on a decline in market value of the timber and his payments to the raft hands while they waited. Avoiding a holding on the issue of foreseeability, the North Carolina Supreme Court refused to allow such "remote and speculative damages," and allowed nominal damages only.[260]

> It requires quite a stretch of the imagination to conceive that had the four gallons of corn whiskey arrived at Thomas, the raft would have been properly constructed, loaded and safely conducted over a

257. *E.g.*, Shurtleff v. Occidental Bldg. & Loan Ass'n, 105 Neb. 557, 181 N.W. 374 (1921) (delay due to failure to make loan caused increase in construction costs and loss in rents). *See also* notes 203, 234 *supra* and note 274 *infra*.

258. Hooks Smelting Co. v. Planters' Compress Co., 72 Ark. 275, 79 S.W. 1052 (1904).

259. *Id.* at 285, 79 S.W. at 1056. In McKinnon v. McEwan, 48 Mich. 106, 109, 11 N.W. 828, 829 (1882), the court asked: "If a vessel were delayed in port for want of a bowsprit, should a loss of freight, to the amount perhaps of thousands of pounds, be obtained in damages?" For an expression of this view under the UCC, *see* Keystone Diesel Engine Co. v. Irwin, 411 Pa. 222, 191 A.2d 376 (1963). And *see* Missouri Dist. Tel. Co. v. Morris & Co., 243 F. 481 (8th Cir.), *cert. denied*, 245 U.S. 651 (1917), where the court stressed the large compensation in allowing recovery.

260. Newsome v. Western Union Tel. Co., 153 N.C. 153, 69 S.E. 10 (1910).

> heavy freshet to Wilmington and the merchandise duly and profitably marketed. Whiskey is very potential at times, but it cannot be relied upon to produce such beneficent results as claimed for it in this case.[261]

As is often true for carriers and telegraph companies, the issue of foreseeability may also be avoided because recovery of consequential damages has been expressly precluded through a contract provision to that effect. Nonetheless, the residue of these troublesome cases that cannot be disposed of on such other grounds is sufficient to call into question the adequacy of the test of foreseeability.

Why, it should be asked at the outset, should any such limitation at all be imposed on liability in contract? Liability in tort knows no such restriction and is bounded only by the limits of "proximate cause."[262] The most satisfactory answer is that the requirement of foreseeability in contracts is a desirable means of shifting entrepreneurial risk. As Patterson wrote:

> If we may assume that the defaulting promisor is usually an *entrepreneur*, a businessman who has undertaken a risky enterprise, the law here manifests a policy to encourage the *entrepreneur* by reducing the extent of his risk below that amount of damage which, it might be plausibly argued, the promisee has actually been caused to suffer.[263]

According to Charles McCormick, this diminution of the risk of business enterprise "hamonized well with the free trade economic philosophy . . . during which our law of contracts became systematized."[264] The common law, having come by the end of the seventeenth century to protect the promisee's expectation interest,[265] came during the middle of the nineteenth century to place significant limitations on the extent to which he could recover damages for disappointed

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261. *Id.* at 156, 69 S.E. at 11. It is also possible that the court may deny recovery by simply refusing to admit foreseeability. A typical example is Kerr S.S. Co. v. Radio Corp. of Ameriea, 245 NY. 284, 157 N.E. 140 (1927), in which a business sent a long and expensive radiogram in cipher directing the loading of a ship. When the radiogram was not transmitted, the ship was not loaded, the freight was lost, and the business sued the telegraph company for damages based on this loss. The New York Court of Appeals reversed the judgment of the two lower courts which had held that, although the telegraph company could not read the cipher, the message must have been understood, judging from its length, its cost, and the names of the parties, as relating to a business transaction. According to J. DAWSON & W. HARVEY, CASES ON CONTRACTS AND CONTRACT REMEDIES 46 (1969), the record indicated that a copy of the code book, which was widely used by business firms, was kept along with others in the telegraph company's office for the use of its customers, and about 80% of the radiograms sent were in some kind of code. But Judge Cardozo wrote:

> The defendant upon receiving from a steamship company a long telegram in cipher to be transmitted to Manila would naturally infer that the message had relation to business of some sort. Beyond that, it could infer nothing. . . . Notice of the business, if it is to lay the basis for special damages, must be sufficiently informing to be notice of the risk.

245 N.Y. at 288, 157 N.E. at 141.

262. The RESTATEMENT uses the term "legal cause." RESTATEMENT (SECOND) OF TORTS § 9 (1965).

263. Patterson, *The Apportionment of Business Risks Through Legal Devices*, 24 COLUM. L. REV. 335, 342 (1924).

264. MCCORMICK § 138 at 567.

265. Farnsworth, *supra* note 1, at 590-99.

expectations. Analogous is the limitation that generally denies liability in contract for mental suffering or emotional distress, the risk of which must ordinarily be borne by the injured party.[266]

If some limitation is desirable, one based on foreseeability is a reasonable choice. Although it is now generally denied that the limits of a promisor's liability are in effect "implied terms," to be derived from the "intention" of the parties, real or fictitious,[267] it is still common to rationalize the test of foreseeability, as did Baron Alderson,[268] on the ground that if the promisor foresaw or could have foreseen the risk, he could have taken it into account, as by an express provision in the contract if he chose not to assume it. The following analysis by Hart and Honoré reflects this rationalization:

> If loss likely to occur at the time of breach but not at that of contracting was taken into account, defendant would be forced to pay compensation for items the possibility of which might have led him, had he known of them, not to conclude the contract or to limit his liability under it.[269]

This argument rests on the same assumptions as does that for implied terms in general: that reasonable contracting parties foresee what is foreseeable, and that they provide expressly for risks that they foresee—assumptions that are questionable at best, at least outside the realm of carriers, telegraph companies, and the like.[270]

The difficulty, however, in the cases where the injured party's *loss in value* is greatly out of proportion to the benefit that the party in breach was to have received in return, is not that the test of foreseeability unduly circumscribes liability; on the contrary, it is that it does not restrict it enough. Although *Hadley v. Baxendale* was originally seen as a limitation on liability, the problem here is that it may not limit it enough. This difficulty even moved McCormick to see merit in the widely repudiated "tacit agreement" test, although he recognized that it

> adds the fiction of a tacit promise to the original fiction of "contemplation," and seldom is there anything in the situation more definite and mandatory than the judge's sense of justice to tell him to find the presence or absence of this silent promise to assume the risk. The recurrent cropping up of the idea in the opinions of the courts indicates

266. *E.g.*, Gefter v. Rosenthal, 384 Pa. 123, 119 A.2d 250 (1956) (defendant caterer charged the plaintiff's guests for checking their coats at plaintiff's wedding anniversary dinner). There are, however, exceptions where recovery has been allowed. *E.g.*, Lamm v. Shingleton, 231 N.C. 10, 55 S.E.2d 810 (1949) (defendant's failure adequately to seal the vault containing the body of the plaintiff's husband caused her shock); Westesen v. Olathe State Bank, 78 Colo. 217, 240 P. 689 (1925) (defendant bank's failure to honor the plaintiff's checks left him without financial resources on a trip to California).

267. *See* 5 CORBIN § 1010. For the older view, *see* note 238 *supra*.

268. *See* note 236 *supra*.

269. H. HART & A. HONORÉ, *supra* note 223, at 283-84.

270. Farnsworth, *Disputes Over Omission in Contracts*, 68 COLUM. L. REV. 860, 872-73 (1968).

> that some of the judges have found the conception useful in giving expression to this sense of justice of the situation.[271]

Such a patent fiction is, however, a poor device to use to gain flexibility.

Leon Green urged abandonment of the test of foreseeability of consequences in favor of another which he described in this way:

> The formula is one for use in determining whether the *interest* involved is protected by the agreement. And it is not a contemplation of *consequences* from a possible breach, but a contemplation of *interests* which may be protected by the contract. Parties, in making contracts, rarely contemplate *the losses* which would result from its breach. But they do count the advantages they will gain from its performance. What *interests does the contract promote or serve*?[272]

But in applying his suggestion he had difficulty in avoiding traditional reasoning. Thus, in regard to a seller's breach of his promise to deliver goods, Green stated that

> the only interest, in the absence of peculiar information that will be recognized as covered by their contract, will be [the buyer's] interest in making a resale of the goods on the market . . . .[273]

A more satisfactory solution would be to preserve the test of foreseeability as the outer limit of liability in contract, but to recognize a judicial prerogative to further reduce that liability in the light of a convincing showing that although the consequences were foreseen, or at least foreseeable, the risk was *not* assumed by the promisor or, to use Green's terminology, the interest was *not* protected by the contract. Such a showing might, for example, be made by demonstrating the kind of disproportion that has just been discussed. Factors that might be influential in rebutting such a showing would include the ease with which the promisor, such as a carrier or telegraph company, might have included an express limitation if it had chosen to do so, and the intentional or willful character of the breach.[274] In an appropriate case it is conceivable that a court might even tailor recovery so as to split the risk between the two parties and meet the objection of one commentator that the traditional rule "usually permits only

271. McCormick § 141 at 580. *But cf.* McKibbin v. Pierce, 190 S.W. 1149 (Tex. Civ. App. 1916) (promisor held liable although he refused to assume liability based on special circumstances when he was given notice of them).

272. L. Green, Rationale of Proximate Cause 51 (1927).

273. *Id.* at 53.

274. McCormick § 140.

> Our rules should sanction, as our actual practice probably does, the award of consequential damages against one who deliberately and wantonly breaks faith, regardless of the foreseeability of the loss when the contract was made.

Id. § 141 at 581. For an example of a case in which the "wilful" nature of the breach was taken account of in this connection, *see* Miholevich v. Mid-West Mut. Auto Ins. Co., 261 Mich. 495, 246 N.W. 202 (1933) (the insured, "a man without means," was not limited to damages based on interest when his automobile insurer's "wilful neglect" to pay a judgment caused his imprisonment and consequent "shame and mortification as well as loss of time"). *See* notes 203, 234 and 257 *supra*.

all-or-nothing recovery."[275] In any event, the solution suggested here would have the dual advantage that judicial departure from the traditional test of foreseeability would be exceptional, to be made only on an affirmative showing of appropriate circumstances, and that it would be done overtly without reliance on fiction.[276]

VIII. Seventh Choice: Preponderance of Evidence or Certainty?

The requirement of "certainty" in the proof of contract damages, which had taken root in eighteenth-century England, fell on fertile soil in nineteenth-century America, where judges were more inclined than their English brethren to control the discretion of jurors in awarding damages. The requirement serves as a basis not merely for instructing the jury, but for passing on the admissibility of evidence and for withdrawing some elements of damage from the jury's consideration altogether. McCormick regarded its development here as "probably the most distinctive contribution of the American courts to the common law of damages."[277] An early American phrasing of the requirement insisted that

> damages claimed should in all cases be shown by clear, and satisfactory evidence, to have been actually sustained. It is a well established rule of the common law that the damages to be recovered for a breach of contract must be shown with certainty, and not left to speculation or conjecture . . . .[278]

Although contemporary statements commonly soften the phrasing of the requirement to insist only on "reasonable certainty" rather than "certainty" itself,[279] its effect is nonetheless to increase the injured party's burden of persuasion well beyond the usual one of making out his case by the "preponder-

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275. Comment, *Lost Profits as Contract Damages: Problems of Proof and Limitations on Recovery*, 65 Yale L.J. 992, 1020 (1956).

276. Frequently it is said that the defendant ought not to have to pay for unforseen injuries, because if he had foreseen such a liability he would have required a larger compensation. This may sometims be true. It is probable in most cases, however, that when a man is assenting to a contract he does not regard the risk of his own nonperformance as great and he fixes the compensation with reference to the cost of his performance and not with reference to the penalty for nonperformance.

5 Corbin § 1008.

277. McCormick § 32 at 124. McCormick also points out that in England "Problems of certainty of amount are usually discussed under the vague rubric of 'remoteness.'" *Id.* § 25 at 98.

278. Griffin v. Colver, 16 N.Y. 489, 491 (1858).

279. Restatement § 331(1) provides that damages are recoverable "only to the extent that the evidence affords a sufficient basis for estimating their amount in money with reasonable certainty." Comment 1 to UCC § 1-106 goes far beyond this and states that the Code's provision that its remedies are to be "liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed," is intended to reject any doctrine that damages must be calculable with mathematical accuracy. Compensatory damages are often at best approximate: they have to be proved with whatever definiteness and accuracy the facts permit, but no more.

ance or greater weight of the evidence."[280] In practice its major impact is limited to the ingredient of *loss on the bargain*, as contrasted with *other loss*, for it is in hypothesizing the position in which the injured party would have found himself if the contract had been performed—in order to determine the component of *loss in value*—that certainty is hardest to attain.[281]

Even as to *loss on the bargain*, there is ordinarily little difficulty in meeting the requirement in the situations typified by Illustrations 3b and 6,[282] in which a supplier sues a recipient for damages. In these cases the maximum *loss on the bargain* under Formula A[283] is equal to the component of *loss in value*, which is simply the price fixed in the contract. Courts have not generally been deterred from awarding damages by such relatively minor difficulties as lack of precision in allocating indirect costs so as to determine exactly how much should be subtracted as *cost avoided*.[284]

Nor have courts been much troubled by uncertainty in the situations typified by Illustration 1,[285] where a recipient who is a middleman sues his supplier for damages, claiming that the breach prevented him from realizing a profit on resale.[286] In these cases the *loss in value*, which is the outer limit of his *loss on the bargain* under Formula A, may be established by an actual contract of resale, should there be such a contract, or by the price on the resale market, should there be such a market. The most substantial part of the *cost avoided* is ordinarily the price fixed by the contract in suit. To this must be added such specific costs as those for delivery as well as an appropriate portion of the general overhead for such activities as merchandising and advertising. Even if these additional costs cannot be determined with great accuracy, recovery is limited by the difference between the actual or hypothetical resale price and the contract price. Of course where the middleman is

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280. *See* F. JAMES, *supra* note 32, at § 7.6.

281. Some cases in the early part of the nineteenth century had suggested that there could be no recovery for loss of profits.

> Both the English and American cases have generally adhered to this denial of profits as any part of the damages to be compensated, and that whether in cases of contract or of tort.

T. SEDGWICK, *supra* note 56, at 78. In Griffin v. Colver, 16 N.Y. 489, 491 (1858), however, the court explained,

> It is not a primary rule, but is a mere deduction from that more general and fundamental rule which requires that the damages claimed should in all cases be shown, by clear and satisfactory evidence, to have been actually sustained. . . . [I]t is under this rule that profits are excluded from the estimate of damages . . . , and not because there is anything in their nature which should per se prevent their allowance.

Some courts still deny recovery for loss of "good will." *E.g.*, Harry Rubin & Sons v. Consol. Pipe Co. of America, 396 Pa. 506, 153 A.2d 472 (1959) (claimed loss of customers was "entirely too speculative" for recovery under UCC § 2-715).

282. Illustrations 3b and 6 are set out in text following, respectively, notes 72 and 211 *supra*.

283. Formula A is set out in text following note 67 *supra*.

284. *See* Comment, *supra* note 275, at 1000-05, 1016 n.137. In order to recover his direct profits, the seller must, as has already been pointed out, show that his supply exceeded his demand.

285. Illustration 1 is set out in text following note 16 *supra*.

286. Comment, *supra* note 275 at 1005-11, 1016 n.137.

to receive an indefinite quantity of goods over a period of time under a continuing relationship, the problems of proof are more acute, the risks of an excessive award are greater, and courts have been less inclined to allow recovery.[287]

The most difficult sort of case in which to meet the requirement is that typified by Illustration 2,[288] in which a manufacturer or other entrepreneur claims that his supplier's failure to furnish capital goods, raw materials, land, or services has prevented him from realizing a collateral profit in a business venture for which they were indispensible.[289] Here it is much harder to establish *loss in value* which, as Formula A shows,[290] involves proof of *collateral income lost* and *collateral cost avoided.* It is no easy task to reduce to simple statements the substance of the plethora of decisions that have applied the requirement of certainty to such cases. Where the venture involves merely a continuation or expansion of an existing and relatively stable business, records of previous transactions may help to show demand for the purpose of calculating *collateral income lost,* particularly where it can be shown that conditions in the relevant market have not changed significantly during the period in question.[291] Costs may be established by past records and sometimes by opinion evidence.[292] Where, however, the venture involves special risks, courts have been reluctant to allow recovery on this basis, even where it is possible to show comparable figures for similar ventures. Especially is this so where the inherent nature of the business gives rise to fluctuations that make it particularly speculative, as it sometimes thought to be the case in the entertainment field,[293] for example. The same is true where the novelty of the venture makes its success unsually uncertain, as may be the case for an enterprise that is wholly new or that involves a new product or service.[294] So, in a Maryland case, *Evergreen Amusement Corp. v. Milstead,*[295] in which a contractor's delay necessitated the postponement of the opening of a drive-in movie theatre from

287. As to the particular complexities introduced by a franchise agreement for brand-name goods, *see id.* at 1006-08. A case analogous to that of the middleman is Brigham & Co. v. Carlisle, 78 Ala. 243 (1884), where the plaintiff was instead a travelling salesman who was to sell shoes on commission over an eight-month period. The court denied him recovery for his lost profits, saying:

> The number and amounts of sales depended on many contingencies—the state of trade, the demand for such goods, their suitableness to the different markets, the fluctuations of business, the skill, energy and industry with which he prosecuted the business, the time employed in effecting different sales, and upon the acceptance of his sales by the defendants.

Id. at 249-50.

288. Illustration 2 is set out in text following note 57 *supra.*

289. *See* Comment, *supra* note 275, at 1011, 1016 n.137.

290. Formula A' is set out in text following note 84 *supra.*

291. *See* RESTATEMENT § 331, Comment *d,* and the cases cited in 5 CORBIN § 1023; MCCORMICK § 29 at 107-08; Note, *The Requirement of Certainty in the Proof of Lost Profits,* 64 HARV. L. REV. 317, 319-20 (1950).

292. On manner of proof, *see* MCCORMICK § 29; Comment, *supra* note 275, at 1026-30.

293. *See* the cases cited in Comment, *supra* note 275, at 1013-14; Note, *supra* note 291, at 320.

294. *See* the cases cited in Comment, *supra* note 275, at 1012; Note, *supra* note 291, at 321-22.

295. 206 Md. 610, 112 A.2d 901 (1955).

the beginning of June until the middle of August, the appellate court upheld the exclusion of the testimony of an expert witness with respect to the estimated profits made by other drive-in theatres in the area during the same period and by that particular theatre during the comparable period of the following year and with respect to a market survey made before the theatre operator selected the site. In the court's words,

> loss of profits from a business which has not yet gone into operation may not be recovered because they are merely speculative and incapable of being ascertained with the requisite degree of certainty.[296]

The extent to which changes in the law of evidence, such as the relaxation of the hearsay rule to admit business records more freely, and changes in the techniques of business, such as greater reliance on analyses of costs and studies of market behavior, will help claimants in meeting the requirement of certainty remains problematical.[297]

McCormick said that, like the test of foreseeability,

> the standard of "certainty" was developed, and has been used, chiefly as a convenient means for keeping within the bounds of reasonable expectation the risk which litigation imposes upon commercial enterprise.[298]

Since there can be no recovery for profits which are not foreseeable, the practical effect of the requirement of certainty is to deny recovery for some profits even though they are foreseeable. It thus has an impact, beyond that

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296. *Id.* at 618, 112 A.2d at 904.

297. *See* Comment, *supra* note 275, at 1018-19. Courts have even differed on whether to award the value of a "chance of winning" where the alternatives are a certain gain or nothing, and turn on a single event rather than on a number of transactions. In Collatz v. Fox Wis. Amusement Corp., 239 Wis. 156, 300 N.W. 162 (1941), Collatz, by estimating the number of jelly beans in a jar, became one of the nine contestants in a quiz contest, in which he was one of the last two survivors. When both survivors failed on the final round, the prize, a new automobile, was awarded to the other survivor on the ground that, because he had been asked his question after Collatz, he was the last contestant eliminated. Collatz's claim for half the value of the car was denied, "for it cannot be assumed nor is it susceptible of proof that had the contest proceeded to a proper finish he would have become the winner." *Id.*, 239 Wis. at 158, 300 N.W. at 164. In Wachtel v. Nat'l Alfalfa Journal Co., 190 Iowa 1293, 176 N.W. 801 (1920), the plaintiff entered a contest in which she could win one of many prizes, including a new automobile, by selling subscriptions to the defendant's newspaper. After several weeks, when the plaintiff was leading in her contest district, the defendant abandoned the contest in that district. The court held that she was entitled to recovery, the amount to be determined by the jury on the basis of the value of the prizes and her reasonable probability of winning one of them. *See*, favoring recovery, RESTATEMENT § 332; 5 CORBIN § 1030; MCCORMICK § 31. *See also* Pollack v. Pollack, 39 S.W.2d 853 (Tex. Comm. App. 1931), where life expectancy tables were used to calculate whether, and for how long one brother would outlive the other. That case is criticized in 45 HARV. L. REV. 585-86 (1932). According to Bonbright, the value of a chance is the discounted value of what it will confer on its possessor. 1 J. BONBRIGHT, *supra* note 62, at 348. Courts have been less sympathetic toward recovery where the uncertain event is within the control of the injured party himself. *See, e.g.*, Western Union Tel. Co. v. Hall, 124 U.S. 444, 458 (1888) (sender's telegram ordering purchase on market delayed a day, following which no purchase was made because of large advance in market during delay; damages based on market rise were denied on ground that "it is not found that he would have resold the next day at the advance").

298. MCCORMICK § 28 at 105.

of the test of foreseeability, in shifting part of the risk of the contracted venture from the promisor to the promisee, and further diminishes the protection that the law affords the promisee's expectations. Fuller and Perdue suggested that where the test of foreseeability is met, but the court still feels that liability would impose on the party in breach a risk disproportionate to the rewards that he expected under the contract, "the test of certainty is the most usual surrogate."[299] As has already been observed, it may be that in some cases where the test of foreseeability is met, full compensation for collateral profits would nonetheless be objectionable. Still, the requirement of certainty has, in this regard, the same disadvantage as the test of foreseeability, in that it tends to support all-or-nothing recovery rather than the sharing of the risk. Furthermore, it has the additional drawback that it purports to be directed, not at considerations of risk, but at considerations of proof and of control of excessive awards.

Even in situations where the claim is to collateral profits, so that the problems of proof are greatest and the risk of excessive verdicts is highest, it is hard to defend a requirement that attempts to cope with the necessity for speculation by denying recovery altogether rather than by resorting to reasonable approximation. That there is some judicial sympathy for this view is suggested by two lines of cases that have eroded the requirement of certainty. In the first, courts have relaxed or abandoned the requirement where they have concluded that it has been met with respect to the "fact" of loss and the only remaining questions go to the "extent" of loss.[300] In the second, they have relaxed or abandoned the requirement where the breach has been characterized as "willful,"[301] in spite of the general tenet that the amount of contract damages does not depend on the character of the breach. To the extent that these cases herald a general relaxation of the requirement of certainty in favor of the normal burden of persuasion, they are to be applauded.

Sometimes, failure to meet the requirement of certainty does not preclude all recovery, but merely results in a lesser amount of damages. Where loss in value is uncertain, the expectation interest may be protected by resort to market price, as where compensation for delay in the construction of a

299. Fuller & Perdue, *supra* note 12, at 376.

300. *See* RESTATEMENT § 331, Comment *a*; MCCORMICK § 27 at 101-02. The distinction is criticized in Note, *Damages—Loss of Profits Caused by Breach of Contract—Proof of Certainty*, 17 MINN. L. REV. 194 (1933).

301. *E.g.*, Wood v. Pender-Doxey Grocery Store, 151 Va. 706, 144 S.E. 635 (1928). In Vitex Mfg. Corp. v. Caribtex Corp., 377 F.2d 795, 797 (3d Cir. 1967), the court said:

> It must be remembered that the difficulty in exactly ascertaining Vitex's costs is due to Caribtex's wrongful conduct in repudiating the contract before performance by Vitex. Caribtex will not be permitted to benefit by the uncertainty it has caused.

See MCCORMICK § 27 at 101-03; Bauer, *The Degree of Moral Fault as Affecting Defendant's Liability*, 81 U. PA. L. REV. 586 (1933). Corbin gives as an illustrative situation, "the case of a defendant who has sold his business and good-will and then in breach of his promise opens up a competing business in the immediate vicinity." 5 CORBIN § 1020.

building is awarded on the basis of rental price for the period of delay.[302] Or recovery may be limited to protection of the reliance interest, as was done in the *Behan* case.[303] Both techniques were applied in the *Evergreen Amusement* case, where the damages awarded to the theater operator were based on the rental price of the theater property for the period of delay together with out-of-pocket costs for that time. At least to the extent that a lesser sum may be awarded, the requirement of certainty does not impose the Draconian choice of all or nothing.

CONCLUSION

Viewed in retrospect, our system of remedies for breach of contract can be seen to have inherent in it seven critical choices: (1) to aim at relief to the promisee to redress breach rather than compulsion of the promisor to prevent breach; (2) to base relief on the promisee's expectation interest rather than on his reliance or restitution interest; (3) to make the usual form of relief substitutional rather than specific; (4) to base recovery on diminution in value rather than on cost to complete; (5) to limit recovery to unavoidable loss rather than all loss caused; (6) to limit recovery to foreseeable loss rather than all loss caused; and (7) to limit recovery to loss proved with certainty rather than loss proved by the preponderance of the evidence.

None is more ingrained than the first of these, the choice of relief over compulsion. Virtually never is it departed from overtly, and even covertly only under the most appealing of circumstances.[304] Indeed, so compelling is the policy favoring relief over compulsion that the party who attempts to reverse it by express provision runs the risk that the provision will be stricken as a "penalty clause" rather than a "liquidated damage clause." Curiously, however, this aversion to penalty does not pervade the law of contract as a whole, and

302. *See* RESTATEMENT § 331(2); 5 CORBIN § 1029. Where there is such an alternative under a standard formula, a court may be particularly reluctant to allow profits in the face of an objection that they are uncertain.

303. The *Behan* case is discussed in text accompanying notes 141-43 *supra*. *See* Fuller & Perdue, *supra* note 12, at 373-77, and note that this is one of the explanations of the rule of *Flureau v. Thornhill* mentioned in note 14 *supra*.

304. Examples of instances in which courts have taken some account of the nature of the breach are collected in note 9 *supra*. In none of these instances do the courts speak in terms of "penalty," however, but rather in terms of the basis or measure of damages or the applicability of some limitation on damages—whether damages are to be based on the expectation or the reliance interest, whether damages are to be measured by cost to complete or by market price, whether damages are to be measured by the rise in market price or the loss of resale profit, or the extent to which the loss must be foreseeable and certain. But if the consequence of an aggravated breach is to impose on the party in breach a heavier liability than would be imposed for an innocent breach, the effect is to penalize him for the aggravated nature of the breach. The most appealing of the instances are those discussed in text accompanying notes 98-117 *supra* and in note 189 *supra*, for if no account is there taken of the nature of the breach, the party in breach may wilfully have broken his promise for the purely selfish reason that he would be financially better off by nonperformance than by performance. *See* the discussion of Illustration 3g in text following note 125 *supra*, indicating that a gain of this sort is not directly recoverable by the injured party.

it is often possible under the law of conditions to do what is not permitted under the law of damages. For example, the owner who is interested in having his building constructed exactly to specifications will be better advised to condition the builder's right to payment on compliance with those specifications to the owner's "honest satisfaction" than to attempt to provide a schedule of penalties for noncompliance. The condition will be upheld although it smacks of compulsion that would be impermissible if attempted through the tailoring of remedies.

All seven of the choices have been influenced, to some extent at least, by the free enterprise economy within which the system of remedies operates. As for (1), the factors that have made compulsion of promisors attractive in a planned economy are plainly absent in a free enterprise economy. As for (2), the expectation interest, rather than the reliance or restitution interest, is of particular significance in a market economy in which one of the principal functions of promise is to provide protection against adverse market fluctuations.[305] With respect to choice (3), the preference for substitutional rather than specific relief is peculiarly appropriate in an economy where it is assumed that markets make substitutes freely available. The choice (4) of diminution in value over cost to complete is an understandable one in situations in which expected advantage consists of the realization of profit, as is characteristic of commercially important exchanges in our economy. As to (5), the rule that limits recovery to unavoidable loss has its major impact in situations in which the injured party can avoid loss by going into the market to arrange a substitute transaction. And finally, with respect to both (6) and (7), the limitation of damages to those that are foreseeable and certain can be viewed as reducing the risk undertaken by entrepreneurs in a system of free enterprise.

In the same vein, it is noteworthy that of the seven choices, all except choice (2) have the effect of restricting rather than enlarging the responsibility of the party in breach. All in all, our system of legal remedies for breach of contract, heavily influenced by the economic philosophy of free enterprise, has shown a marked solicitude for men who do not keep their promises.

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305. *See* Farnsworth, *supra* note 1, at 588.