Expectation Damages for Breach of Contract and the Principle of *Restitutio In Integrum*

Justin Orsborn*

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I: INTRODUCTION

It is well established that the purpose of expectation damages for breach of contract under the principle of *restitutio in integrum* is to put parties in the position they would have been in had the contract been performed.[1] The simplicity of this formula, however, belies the conceptual difficulties inherent in the protection of expectations. First, in order to assess the quantum of expectation damages, the courts must hypothesise as to the position the promisee would have occupied, had the contract been performed. In most cases, this will be a matter of evidence, having regard to contractual terms and applying the usual rules of construction. A second difficulty inherent in the expectation measure, and the object of the following discussion, is that of estimating the monetary amount needed to compensate an aggrieved promisee for loss of that hypothetical position.[2]

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* LLB(Hons), MJur

1 *Robinson v Harman* (1848) 1 Exch 850, 855; 154 ER 363, 365 per Parke B.

2 One obvious solution to overcoming the requirements for a hypothesis and an estimate would be to move outside the confines of expectation damages. Equity's remedy of specific performance avoids both the hypothesis and the estimate referred to above and could be said to provide *restitutio in integrum* inasmuch as it places the promisee in the position he or she would have been in had the contract been performed. This remedy, however, is a discretionary one and available only where damages are considered inadequate. Recovery of the reliance or restitution interest would be another means of avoiding hypothesis as to future position. Under these heads of damages, returning to the status quo is all that is required. It follows, therefore, that an estimate of loss will be simplified; it will be a matter of quantifying expenditure that has already been made. There may, however, be limitations as to the availability and the quantum of such damages, forcing many plaintiffs to elect to recover damages under the expectation head. Despite superior remedies, therefore, the courts may still be required to analyse the expectation measure of damages with its inherent problems.

According to Bonbright,[3] there are two means of quantifying in monetary terms the position in which a person is placed, namely, "value" and "cost". In Bonbright's terms, "value" refers to the advantage that is expected to result from 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. In the case of expectation damages, therefore, two distinct methods of compensating for loss of position are apparent. Damages can be based on the "cost of performance", being the financial sacrifice needed to obtain a substitute performance, or on the "diminution in market value", being the loss of advantage resulting from non-performance.

Either measure of damages can be perceived as a valid estimate of the position the promisee would have been in, had the contract been performed. In fact, more often than not, the cost of completing a contract will equate closely to its end value. Values or prices, in the market place at least, are usually a function of cost. Using Bonbright's analysis, contractual performances are often worth what they cost.

On the odd occasion, however, there will be a large discrepancy between the cost of performing a contract and its valuation in market terms.[4] If, in the event of breach, the courts were to award the market value of the contract performance, the promisor would arguably be in the same position *financially* that he or she would have been in, had the contract been performed. If, however, the promisee required performance for reasons other than financial gain, market value damages could hardly be said to have provided *restitutio in integrum.* The only way to restore the promisee's expectations in those circumstances would be to provide the cost of obtaining alternative performance.

The question arises as to how the court should choose between these measures of expectation damages. Which measure best equates with the parties' expectations so as to enable them to be placed in the position in which they would have been had the contract been performed? The academic and judicial responses to this question have been, at best, inconsistent. There are at least three distinct approaches. The first is to assume that in every case the *market value* of the service will always provide *restitutio in integrum.* The second approach, in antithesis to the first, assumes that the *cost of performance* will always place the promisee in the position that he or she would have been in, had the contract been performed. The third approach is to make *no* assumptions as to which measure of damages would most adequately equate with a party's expectations. The measure of damages will, on this analysis, be essentially a question of fact, rather than principle.

It is proposed to discuss and evaluate each of these three approaches with the objective of formulating a valid guide as to which measure of damages – market value or cost of performance – will best provide *restitutio in integrum* for an

3 *The Valuation of Property* (1937) 19, cited in Farnsworth, "Legal Remedies for Breach of Contract" (1970) 70 Colum L Rev 1145, at 1160 n62.

4 Particularly in the case of a contract for services.

injured promisee. The discussion will be confined to contracts for services as these contracts tend to demonstrate the greatest disparity between the cost and value of contractual performance.[5]

II: A MARKET VALUE RULE

The market value model assumes that, in every case, the *market value* of the service will place the promisee in the position that he or she would have been in had the contract been performed. The basis for this view is the premise that every venture is undertaken with a view to maximising monetary wealth. If a contract is left unperformed, the loss suffered by the promisee would be presumed to be the diminution in market value of assets resulting from that non-performance. It is a view of commercial dealings based on what can be loosely labelled "classical liberal economics".

The main arguments put forward in support of a market value rule may be summarised under the headings of "efficient breach" and "the windfall argument".

1. Efficient Breach

Arguably, the most influential school of thought supporting a single measure of contract damages has been the United States school of law and economics. Posner, one of its main recent proponents, has enunciated a model of contract damages designed to ensure economic efficiency from a macroeconomic perspective.[6] Posner argues strenuously in favour of the diminution in market value measure only. In his view, where the cost of performing a contract is greater than its end worth in market terms, such a contract involves an inefficient allocation of resources. Thus, he argues, it would be more efficient for that contract to be breached than to be performed. There will only be an incentive to breach that contract, however, if damages are limited to the market value measure. Having paid damages, the promisor will be free to go away and perform a more profitable and efficient contract.[7]

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5 In property cases, the work and end product are combined into one tangible unit so that any cost/value discrepancy will have been rationalised by the price. There may, however, be a related problem of estimation when an item of property is considered unique or without substitutes. That, however, forms a question beyond the proposed scope of this paper.

6 Kronman & Posner, *The Economics of Contract Law* (1979) 5.

7 Posner goes further and insists that such a view is consistent with the English common law tradition. He points to the doctrine of mitigation which denies the promisee the right to deliberately incur expense or suffer loss after termination of the contract, since allowing him or her to do so would be to sanction waste. In the same way, Posner argues, the courts would not compel a contract of supply if the promisee can easily obtain alternative performance elsewhere. Regardless of whether or not the breach was deliberate, the promisee's remedy would be in damages, effectively allowing the promisor to choose between performance and damages. (See *Photo Production Ltd v Securicor Ltd* [1980] AC 827, 848 (HL) for an analysis of primary and secondary obligations.) Posner argues, therefore, that the common law's adherence to the compensation principle is nothing less than an implicit requirement that damages promote economic efficiency. As Posner reports: "A number of scholars in recent years have claimed that the common law, including the law of contracts, has an implicit economic logic – the purpose, or in any event the effect, of many common law doctrines is, they believe, to increase economic efficiency." Kronman & Posner, ibid. For an express recognition of economic efficiency in the New Zealand context see *Newmans Tours Ltd v Ranier Investments Ltd* [1992] 2 NZLR 68 per Fisher J.

For Posner's argument to be valid, however, it must first be proved that parties are indifferent as to whether or not they receive contractual performance as promised or damages.[8] Such a premise makes sense only if damages are considered an adequate remedy. The law, however, has long recognised that damages may be inadequate. Through its equitable jurisdiction it has been readily prepared to compel contractual performance. As Birks points out,[9] in Scots law there is an assumption that specific performance is the prima facie remedy. Roman law also focused on the primary, rather than the secondary, obligation arising from a contract.[10] Posner, however, considers specific performance to be an aberration from the compensation principle. He accepts the tradition of giving specific performance for contracts for the sale of land on the basis that land value may be difficult to assess.[11] As Spry points out, however, the reason for giving specific performance for land has, historically at least, been a belief that damages are an inadequate remedy.[12] Birks also points out that the efficient breach theory, allowing parties to choose between performance and damages, is difficult to reconcile with the tort of interference with contractual relations as well as restitutionary damages.

Admittedly, some parties will be indifferent as to whether the contract is performed or not. Other parties, however, may subjectively value performance out of necessity and even out of caprice. To those people, any damages, let alone market value damages, are probably the second best solution. A promisee may not care whether the contract is economically efficient; nor may the promisor care, as long as he or she receives the agreed price. To suggest that, having made a bargain, the promisor should then re-evaluate the situation in terms of economic efficiency, becomes absurd.

Rather than considering the circumstances of particular parties, however, Posner is content to base damages claims on the cornerstone of classical economic thinking – people must be assumed to have the maximisation of wealth as their primary goal and thus be concerned solely with the economic loss arising out of a breach of contract. While there may be some benefits in the objectivity such an absolutist approach makes possible, the law has not been prepared (at least traditionally) to adopt such a simplistic approach. To take a uniform view of the

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8 The parties *should be* indifferent as to performance or damages because that outlook would provide the most efficient outcome, and the parties will prefer efficient terms because efficient rules will minimise transaction costs to the parties. This is an application of the so-called "Coase Theorem". See Coase, "The Problem of Social Cost" (1960) 3 J Law & Econ 1.

9 "Restitutionary Damages For Breach of Contract" [1987] LMCLQ 421, 441.

10 Birks, ibid, 441 n103, refers to Buckland, "Cause of Action, English and Roman" in *Reflections on Jurisprudence* (1945) 96.

11 Specific performance in such a case would give the parties an incentive to negotiate – although Posner concedes that this would cause transaction costs to rise, rendering the specific performance remedy less efficient than damages.

12 Spry, *The Principles of Equitable Remedies* (4th ed 1990) 58.

parties' expectations would be to dictate the terms of the contract – something courts have been reluctant to do. So although the approach of the school of law and economics may seem to be a market-driven freedom of contract, with parties free to choose whether to perform or not, there is, inherent in the concept of efficient breach, a centralist and interventionist approach to contractual obligation.

It may even be inferred that there is a hidden agenda: the state will sanction only those contracts that are of benefit to the state, and that contract damages are designed to protect not the individual's interests, but the state's. While an inefficient contract may bring some satisfaction to the individual, if it does not correspond with an increase in utility directly proportionate with its cost, it must be left unprotected in the hope that the contract will be breached. Individuals, therefore, are being herded into entering productive contracts only; those foolish enough to enter a non-productive contract are left open to unscrupulous contract breakers who thereby profit out of their breach. In the final analysis, efficient breach is nothing less than state-sanctioned breach of contract.[13]

However, with respect, a useful principle emerging from Posner's analysis is that, when parties *are* indifferent as to whether the promisor performs or pays damages, the diminution in market value measure would be an appropriate valuation of their expectation interest. Conversely, where the parties are not indifferent, the cost of performance may be more appropriate. Rather than making blanket assumptions about the parties' expectations, the courts should enter into an inquiry, based on evidence of the parties' intentions, as to the value placed on performance by the parties.

2. Windfall Argument

Another argument in favour of the market value measure, connected to the concept of efficient breach, is what can be called the "windfall" argument. It is argued that giving the cost of performance will result in a windfall to the promisee. Again, plaintiffs are assumed to have wanted nothing more than the capital gain that would result from performance. To provide plaintiffs with more than that capital increase, say with the cost of performance, will be to compensate beyond their expectations and provide them with a windfall.[14]

The courts' response to this has often been a philosophical dismissal of the windfall problem as an unfortunate side effect of contractual breach; a side effect that could have been avoided by defendants, had they performed. Beneath the surface is the view that breach is the defendant's fault and if the plaintiff is

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13 The same approach can also be used for tort damages. See Coase, supra at note 8.

14 See for example Farnsworth, supra at note 3, at 1168: "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 .... 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."

enriched in some way as a consequence then that is the defendant's misfortune.[15]

It is submitted, however, that the issue of fault is a "red herring". Whenever there is a breach of contract and the cost of performance is greater than the market value then somebody, either the plaintiff or the defendant, may potentially be the recipient of what can be called a "windfall".[16] The point was acknowledged in the dissenting judgement of Irwin J in *Peevyhouse v Garland Coal & Mining Co*:[17]

> [The defendant] has accepted and reaped the benefits of its contract and now urges that plaintiffs' benefits under the contract be denied. If plaintiffs' benefits are denied, such benefits would inure to the direct benefit of the defendant.

It is only if the incorrect measure of damages is given that there will be a windfall to either party.[18] If the injured party was indifferent as to performance or the financial gain deriving from performance, then an award of damages based on the cost of performance would constitute an unexpected profit. If, by contrast, the injured party valued performance as an end in itself and was uninterested in its financial value, an award of market value damages would provide the breaching party with an unexpected saving.

The problem with assuming that there will *always* be a windfall to the plaintiff is that, like the efficient breach argument, it is based on the premise referred to earlier that contracts are undertaken for financial gain only. If that premise is incorrect, the windfall argument loses ground. The cost of performance would not be a windfall if the plaintiff valued performance as an end in itself, not just for its market value. Conversely, market value would not amount to a saving to the defendant if the market gain from performance was all the promisee expected the promisor to provide.

That is not to say that the windfall argument is not a logical extension of the premise upon which it is based. If contracts *are* undertaken for financial gain only, then to give cost of performance to the promisee would be to provide him or her with a windfall. Conversely, if the contract is valued for its own sake, cost of performance will not provide the plaintiff with a windfall but with compensation. That much is helpful in a search for perfect compensation under the principle of *restitutio in integrum*. But the analysis becomes unhelpful when it is assumed that parties *always* enter contracts for financial gain.

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15 See for example *Bellgrove v Eldridge* (1954) 90 CLR 613, 620.

16 See Harris, Ogus & Phillips "Contract Remedies and the Consumer Surplus" (1979) 95 LQR 581, 593: "Hitherto, the courts seemed to have been concerned that the *promisee* should not make an undeserved "profit" if damages are awarded on the reinstatement basis but the money is used for some other purpose. This assumes that the only question is whether the promisee "deserves" to benefit from the "windfall"; it fails to take into account that when there is a substantial difference between the diminution in market value and the cost of reinstatement, there may be "windfall" to one party or the other."

17 382 P 2d 109, 116 (1963).

18 See *Warren & Mahoney v Dynes*, Court of Appeal. 26 October 88 CA 49/88, at p24 per McMullin J: "On the one view the award may represent a windfall to the Dynes; on the other hand it could be much less than their true entitlement." Noted [1988] BCL 1987.

3. Conclusion

Despite the criticisms outlined above, some useful principles emerge from the arguments based on economic efficiency and windfall to the plaintiff. One general principle that can be taken from them is that, at times, cost of performance damages will overcompensate. In conclusion, however, it must be stated that these arguments are not solid grounds upon which to refuse cost of performance damages.

III: A COST OF PERFORMANCE RULE

A cost of performance rule is most clearly based on the rationale that courts should not rewrite parties' contracts. The court should not by its intervention determine that a plaintiff was interested solely in the financial rewards offered by performance. Furthermore, it may be argued that the courts have no principled reason to look at the plaintiff's motive for entering a contract; the only way to ascertain intention would be to look at the terms of the contract and give effect to them. Implementing contractual terms alone would arguably place the promisee in the position that he or she would have been in, had the contract been performed.

There are two variations to the cost of performance model discussed here. The first is what can be called sanctity of contract. It takes a view of contractual obligation opposite to the efficient breach analysis. The second argument relates to the issue of fault and is indirectly a response to the windfall argument.

1. Sanctity of Contract

The term "sanctity of contract" as used here simply describes a view that the terms agreed by the parties are sacrosanct; they should not be replaced with different terms simply because such terms would result in a more reasonable or efficient outcome. It seems to be this view which influenced Oliver J in *Radford v De Froberville.*[19] The Court was asked to assess damages for the defendant's failure to construct a wall in accordance with a condition of a contract for sale of land by the plaintiff to the defendant. Damages assessed by the diminution in value measure were considered nominal. However, the cost of building the wall in accordance with the contract specifications was, at the date of trial, about £3,400. When discussing which measure would be appropriate, Oliver J stated:[20]

> Now, it may be that, viewed objectively, it is not to the plaintiff's financial advantage to be supplied with the article or service which he has stipulated. It may be that another person might say that what the plaintiff has stipulated for will not serve his commercial interests so well as some other scheme or course of action. And that may be quite right. But that, surely, must be for the plaintiff to judge. Pacta sunt servanda. If he contracts for the supply of that which he thinks serves his interests – be they commercial, aesthetic or merely eccentric – then if that which is contracted for is not supplied by the other contracting party I do not see why, in principle, he should not be compensated by being provided with the cost of supplying it through someone else or in a different way....

19 [1977] 1 WLR 1262 (Ch D).
20 Ibid, 1270.

Irwin J in his dissenting judgment in *Peevyhouse* also criticised looking outside the terms to ascertain what advantage performance would bring to the plaintiff:[21]

> [It] completely rescinds and holds for naught the solemnity of the contract before us and makes an entirely new contract for the parties.

On the face of it, these statements of principle seem accurate; parties should surely get what they contracted for. That, after all, was the criticism levelled earlier at Posner's approach; that he would have the courts impose their concept of value onto the parties. The problem is that it cannot always be assumed that the terms of contract read *at face value* will necessarily be the best guide as to what position the plaintiff would be in if the terms are not honoured. The terms of the contract may be collateral to the advantage expected by the promisee from the performance of those terms.

For example, an entrepreneur may buy a block of flats, intending to redecorate them and resell them at a profit. If she hires a painter to paint the roofs of the flats green, but by mistake the painter paints them grey, the entrepreneur has arguably still received the advantage expected from performance of the contract, namely, the newly improved flats. In other words, the entrepreneur sought performance purely for financial gain, not because of any preference for the colour green. In such a case, the terms of the contract would not provide an accurate picture of the expected advantage.

A useful guide as to what advantage the plaintiff expected from performance *may* be the actual terms of the contract, but this cannot always be the case. It is a fallacy that contract damages are designed to secure substitute performance. The often quoted rule in *Robinson v Harman*[22] states that the purpose of contract damages is to place the injured party in the position he or she would have been in, had the contract been performed. To assume that all losses arising from breach of contract will always be as a result of unperformed terms would be to negate such measures of damages as consequential losses, reliance losses, damages for lost profits, and a number of other different heads of contracts. Thus, in a case concerning the assessment of reliance losses, *Commonwealth v Amann Aviation Pty Ltd,*[23] Brennan J felt able to say:[24]

> In evaluating a plaintiff's benefits under a contract, the court does not look solely at the express terms of the contract but evaluates the plaintiff's rights to benefits of any kind, whether those benefits are expressed by the terms of the contract or are ascertainable by reference to circumstances extrinsic to those terms.

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21 Supra at note 17, at 115. See also the same Court in *Great Western Oil & Gas Company v Mitchell* Okl, 326 P 2d 794, 798 (1958), citing *Anthis v Sullivan Oil & Gas Company* 203 P 187: "The law will not make a better contract for parties than they themselves have seen fit to enter into, or alter it for the benefit of one party and to the detriment of the others; the judicial function of the court of law is to enforce the contract as it is written."

22 Supra at note 1.

23 (1991) 66 ALJR 123.

24 Ibid, 137-138. Brennan J offered as examples the case of *Manubens v Leon* [1919] 1 KB 208, where a hairdresser's assistant who was wrongfully dismissed was held entitled to damages not only for lost wages but for lost tips; and in *Herbert Clayton and Jack Waller Ltd v Oliver* [1930] AC 209 (HL), the opportunity of gaining fame and reputation was considered relevant when assessing damages for the wrongful termination of a theatrical appointment.

Of course, damages must be confined to those losses that arise as a result of the breach of promise,[25] but this does not change the principle that such losses will *not* always be directly related to the terms. The terms of the contract will be useful for assessing loss when the plaintiff has a strong interest in performance per se, rather than the financial gain accruing from it. For example, returning to the roof painting contract referred to above, if the promisee were a private owner who *did* have a strong preference for the colour green, only the cost of repainting the roof green would suffice to compensate for non-performance.

Thus the "sanctity of contract" approach makes a mistake similar to that made by the market value school; it makes blanket assumptions as to the value that the parties placed on performance as defined by the terms. Under this approach, parties are always assumed to value performance as an end in itself; hence the need for strict adherence to terms. Again the logic of the approach is correct; where performance *is* valued per se, the terms of the contract should be strictly applied. It is simply that such a valuation cannot be considered an absolute.

2. The Issue of Fault

Another response to both the efficient breach and the windfall arguments is to say that where a plaintiff deliberately breaches a contract, it would be *unconscionable* to allow him or her to make a saving as a result of that breach. In Farnsworth's view, the underlying policy governing awards of cost of performance is the issue of deliberate breach.[26]

The Supreme Court of Minnesota was express in its recognition of the defendant's fault as the rationale for rejecting problems of windfall to the plaintiff. In *Groves v John Wunder Co*,[27] the defendant leased the plaintiff's property for the purposes of removing sand and gravel. The defendant promised to restore the surface of the property to a level grade at the duration of the lease, but deliberately failed to do so. The loss, assessed as the diminution in market value of the property, was estimated at $12,160. The cost of performing the promised service, however, was estimated as in the region of $60,000. The court at first instance awarded the smaller measure. In overturning this decision the Supreme Court awarded the cost of performance measure, stating:[28]

> It is suggested that because of little or no value in his land the owner may be unconscionably enriched by such a reckoning. The answer is that there can be no unconscionable enrichment, no advantage upon which the law will frown, when the result is but to give one party to a contract only what the other has promised; particularly where, as here, the delinquent has had full payment for the promised performance.

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25 A point noted by Gaudron J in *Commonwealth v Amann Aviation*, supra at note 23, at 159.

26 Supra at note 3, at 1170.

27 205 Minn 163; 286 NW 235 (1939) (Minn S Ct), cited in McCormick & Fritz, *Cases and Materials on Damages* (2nd ed 1952) 587.

28 Ibid, 591.

Consideration of fault seems to have its source more in equity than in the common law. Cost of performance damages, while ostensibly awarded at common law, often in reality appear to be given in lieu of specific performance at equity. In his dissenting opinion in the *Peevyhouse* case Irwin J said:[29]

> [D]efendant had knowledge ... that the cost of performance might be disproportionate to the value or benefits received by the plaintiff for the performance. Defendant has received its benefits under the contract and now urges, in substance, that plaintiffs' measure of damages for its failure to perform should be the economic value of performance to the plaintiffs and not the cost of performance .... The defendant could have performed the contract if it desired. It has accepted and reaped the benefits of its contract and now urges that plaintiffs' benefits under the contract be denied. If plaintiffs' benefits are denied, such benefits would inure to the direct benefit of the defendant. Therefore, in my opinion, the plaintiffs were entitled to specific performance of the contract and since defendant has failed to perform, the proper measure of damages should be the cost of performance.

The issue of fault may be relevant to a grant of specific performance, which may be the better remedy for deliberate breach.[30] However, while this issue is emotionally attractive it has traditionally had little application to common law damages. Nor should it have any relevance to damages in lieu of specific performance.[31] As the dissenting members of the bench in *Groves v Wunder* emphasised, the rule of damages to be applied in any given case has for its purpose compensation, not punishment.[32] The only valid reason that cost of performance should be given at common law is when that is what would best give effect to the parties' intentions, objectively assessed, at formation.

3. Conclusion

Any rigid approach to compensating for lost expectations is, it is submitted, misconceived. The misconception, in the case of the cost of performance rule, is that damages are designed primarily to provide a promisee with some kind of surrogate performance. That is not the more general compensatory role of damages as espoused by Parke B in *Robinson v Harman*. Damages in contract are designed to compensate for the promisee's disappointed expectations. It may be true that surrogate performance is the only way to provide *restitutio in integrum* but that cannot be assumed. To assume that a promisee is always interested primarily in performance is to allow the situation where a promisee receives everything expected from the contract (for example the financial gain from it), but because of a technical breach of contract claims the full cost of performance in damages as well.[33] This surely goes beyond the principle of *restitutio in integrum*. The correct

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29 Supra at note 17, at 115-116.

30 See Schwartz, "The Case for Specific Performance" (1979) 89 Yale LJ 271, 305. See also Linzer, "On the Amorality of Contract Remedies – Efficiency, Equity and the Second Restatement" (1981) 81 Colum L Rev 111, 138.

31 There is no reason why damages at equity would be assessed any differently to the common law. See *Wroth v Tyler* [1974] Ch 30; and *Tito v Waddell (No 2)* [1977] Ch 106.

32 Supra at note 27, at 592.

33 The classic example is *Joyner v Weeks* [1891] 2 QB 31, where a lessor was held entitled to the cost of repair at the end of the lessee's term even though the property had been already re-let.

approach must be to look at awards of damages on a case by case basis to determine which measure of damages will most adequately fulfil the promisee's expectations.

IV: A CASE BY CASE APPROACH

The question, however, is how to decide which of these measures would be appropriate. To answer this question, as many of the cases do, by choosing the measure that best compensates the promisee is merely to beg the question whether the parties expected actual performance or simply the capital gain from performance. This is, in essence, a question of fact that is perhaps best resolved by reference to the laws of evidence rather than substantive principle.[34] Having said that, however, it is submitted that the law of expectation damages is a specialised set of principles used to interpret evidence of the parties' intentions. As such, it will be appropriate to analyse some of the approaches taken to this problem and determine a workable set of guidelines for determining the appropriate measure of contract damages.

1. Intention Test

One of the tests that has evolved at common law for deciding whether or not to give cost of performance damages is an inquiry as to whether the plaintiff would use the damages to perform. This is an express attempt to counter the windfall argument. The concept received some recognition in two English cases, at first instance, at about the same time. In the first of these, *Tito v Waddell (No 2)*,[35] the Court was asked to assess damages for the defendant's failure to replant a Pacific atoll in accordance with contractual terms. The difference between the market value and the cost of performance was huge. The diminution in market value as a result of non-performance was assessed at about $75 per acre, whereas the cost of replanting was estimated to be $75,000 per acre. Megarry V-C considered that the crucial factor to be taken into account was whether the plaintiffs proposed to take the money awarded as damages and seek alternative performance. If the plaintiffs intended to pocket the money and not seek alternative performance, then they should receive only market value damages. His Lordship went so far as to propose that an undertaking could be given, by the plaintiffs' counsel, to warrant that the plaintiffs would do the work. That, he suggested, would "surely compel fixity of intention."[36]

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34 As it was noted by Viscount Haldane LC in *British Westinghouse Electric and Manufacturing Co Ltd v Underground Electric Railways Co. of London Ltd* [1912] AC 673, 688 (HL): "The quantum of damage is a question of fact, and the only guidance the law can give is to lay down general principles which afford at times but scanty assistance in dealing with particular cases." See also dicta to the same effect by Cooke P in *McElroy Milne v Commercial Electronics* [1993] 1 NZLR 39, 41 (CA).

35 Supra at note 31.

36 Ibid, 333.

The second case immediately following *Tito* which affirmed its findings (although with a converse result), in particular the use of this so called "intention test", was *Radford v De Froberville.*[37] Oliver J stated:[38]

> In the instant case I am entirely satisfied that the plaintiff genuinely wants this work done and that he intends to expend any damages awarded on carrying it out. In my judgement, therefore, the damages ought to be measured by the cost of work, unless there are some other considerations which point to a different measure.

So, in this case, intention to do the work was, as in *Tito*, a prerequisite for an award of cost of performance damages.

(a) Traditional contract theory

The most fundamental objection to this approach must be its incompatibility with traditional contract theory. The relevant time for assessing the monetary cost or value of expectations is the time of formation.[39] The intention test, however, seems more directed toward the assessment of the position the parties expect to occupy post-formation – in fact, after the contract has ended and damages have been awarded. Looking at the plaintiff's intentions post-breach does little to account for expectations formed at the time of entering the contract. It also does little to preserve any of the normal interests compensated for by damages. As Jones in his discussion of the case suggests:[40]

> To say that a defendant is liable for the cost of replanting only if the plaintiff intends to replant must seem strange to the businessman who knows what he has promised to do; as Pollock[41] and Buckland[42] said, such an argument makes a nonsense of the reasonable expectations of promisees. It carries Mr Holmes' "bad man" theory of contracts[43] to extremes, and unrealistically concludes that the plaintiff has no "right" for the waiver of which he could have exacted a significant consideration. Moreover to say, with Oliver J,[44] that a plaintiff who is awarded the cost of performance must "mitigate" his loss by doing what the defendant failed to do is to formulate a novel principle which is unknown to the law of sales and commercial contracts. Once a court has determined what a plaintiff's loss is, it does not monitor what he does with the damages which are the measure of that loss.

Intention to perform may provide *indirect* evidence that the promisee placed value on performance per se from the outset, but it cannot be determinative. A party may have an intention to perform for reasons other than valuing performance as an end in itself. In *Radford*, Oliver J refrained from "expressing any view about what the position would be if his motives were merely capricious".[45] Reading

37 Supra at note 19, at 1283.

38 Ibid, 1284.

39 See recent New Zealand Court of Appeal dicta to that effect in *Citibank NA v Stafford Mall Ltd*, noted in [1992] BCL 1328.

40 Jones, "The Recovery of Benefits Gained From a Breach of Contract" (1983) 99 LQR 443, 450.

41 *The Pollock-Holmes Letters*, Vol I, 79-80, 120; Vol II, 201, 234, cited ibid, 450 n57.

42 Buckland, "The Nature of Contractual Obligation" (1944) 8 CLJ 247, cited in Jones, supra ant note 40, at 450 n58.

43 De Wolfe Howe (ed), *The Common Law*, 235-237, cited in Jones, supra ant note 40, at 450 n59.

44 See *Radford v De Forberville*, supra at note 19, at 1272.

45 Ibid, 1285.

between the lines, it would appear that his Honour would have taken a different approach had the intention to perform been less than sincere. A search for sincerity is again at odds with the objective theory of contract.

Thus, in the line of authority which has consistently upheld the lessor's right to seek damages for the tenant's failure to repair, damages are assessed at the cost of repair irrespective of whether the lessor intended to re-let the premises or not. What the lessor did with the damages was considered to be *res inter alios acta.*[46] The same principle is applied in the defective building cases. As the High Court of Australia stated in *Bellgrove v Eldridge*,[47] what a plaintiff does with his or her damages is "quite immaterial".

However, in his commentary on *Tito v Waddell*, Birks attempts to provide some rationale for the test, stating that cost of performance could be claimed only:[48]

> [I]f that cost could be seen as a loss to the claiming plaintiff, and it could only be seen as a loss if the plaintiff was going to do the work. Hence, there would have to be evidence that he did intend to do it, and the evidence was lacking.

In other words, one way to ascertain the plaintiff's intentions at the time of formation would be to inquire as to what the plaintiff planned to do with the damages. If that was the emphasis placed upon intention to perform by Megarry V-C in *Tito*, then, with respect, that may in a limited way conform with objective theory. But that was not the emphasis given. Intention to perform was not viewed as evidence of value at the time of formation, but as determinative of whether cost of performance would have been given. It is agreed that if the plaintiff intends to perform, that will provide *indirect* evidence of value at formation, which in turn provides evidence of loss. However, it must remain evidence only, and not be conclusive.

It must be conceded that it is within the courts' competence to place conditions on an award of damages. Conceivably, if a court were convinced that cost of performance damages would best compensate a promisee, it could order that the damages be used to obtain substitute performance, provided that obtaining alternative performance was not the rationale for giving such damages. Such an order would, however, be paradoxical inasmuch as it would, in effect, be an order of specific performance against the plaintiff.

(b) Problem of supervision

There would also be the problem of supervision. Usually an award of damages involving cost of performance, whether at common law or equity, is given as an alternative to specific performance. In cases involving large service contracts, specific performance is often refused because of the difficulty in supervising the work. It would seem ludicrous, therefore, to refuse specific performance for that

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46 See *Joyner v Weeks*, supra at note 33.

47 Supra at note 15, at 620.

48 Supra at note 9, at 432.

reason, but give cost of performance damages on the basis that the work will be done. There will either be some uncertainty that it will be done, or the courts will have to supervise it.[49] If that is the case, why not order the defendant to do the work and save on the cost of the plaintiff's negotiation for alternative performance?

2. The Consumer Surplus Approach

Harris, Ogus and Phillips[50] approach the issue of damages from the perspective of utility. Where a promisee expects to receive a utility from performance in excess of the utility he or she associates with the price of that performance, a consumer surplus exists. As they explain:[51]

> The concept of consumer surplus is important in any attempt to measure consumer losses because, unlike firms, consumers make purchases for the pleasure or utility they confer; this utility has no necessary relationship with the price paid, and is of quite a different order from market prices or business profits. It is of course difficult to measure utility, but generally economists avoid the conceptual problem by measuring utility in terms of the maximum amount a consumer would pay for a particular purchase .... Therefore, willingness to pay, rather than market price, is the appropriate measure for estimating the value of a purchase, and the consumer surplus is the difference between this value and the market price.

Although framed in terms of a distinction between consumer and commercial contracts, Harris *et al* acknowledge that a consumer surplus can also exist for a firm – for example where a contractual performance is desired for its use value. Essentially, therefore, where there is a difference between the price the market places on performance and the value *the promisee* places on it, there is a consumer surplus which arises out of the contract.[52]

This approach, it is submitted, is to be preferred. There is nothing sophisticated about a theory that reduces the question of damages to a basic question of fact – was there or was there not expected utility above the utility assessed by the market? The advantage, however, of the consumer surplus approach is that by

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49 As to problems with supervision see *Radford v De Froberville* supra at note 19, at 1284; *Wigsell v School for Indigent Blind* (1882) 8 QBD 357; *Tito v Waddell (No 2)*, supra at note 31, at 334; *Conquest v Ebbets* [1896] AC 490 (HL). See also Birks, supra at note 9, at 432; "This is highly unsatisfactory. The condition for securing a substantial award in respect of that part of the consideration unperformed is evidence of an intent on the part of the plaintiff as to the future, which intent can be abandoned once the damages are safely in the pocket. The hope of judicial supervision is vain."

50 Supra at note 16.

51 Ibid, 583. See also Macdonald, "Breach of Contractual Obligation: Cost of Work or Market Value?" (1988) 52 Conv & Prop Law, 421: "This "consumer surplus" has been defined as "the excess utility or subjective value" which would have been obtained from the contracted work. It would not be matched by any associated utility reflected in the market price."

52 It could be asked whether an interest in the consumer surplus is nothing less than a search for subjective value. However, the consumer surplus approach maintains the need for objectivity. If the plaintiff can show that he or she values or prefers actual performance (as opposed to the capital gain from performance) and the cost of performance is greater than its market value, there will be a consumer surplus.

assessing damages on the basis of utility, an objective approach is taken to assessing intentions at the relevant time – namely the date of formation. This accords with the objective theory of contract.

The courts will need to be able to assess what the promisee expected at the time of formation. Obviously more than just a declaration from the promisee at the time of trial will be required.[53] It becomes, therefore, mostly a matter of evidence[54] as to what it was that the plaintiff really wanted. Did he or she value actual performance as an end in itself? Or would he or she have been equally happy with the capital gain that would have accrued from performance?

In the case of contracts for services, where a consumer surplus is found to exist, the measure of damages should be the cost of performance damages.[55] That amount, providing substitute performance is available, would enable the plaintiff either to attain that consumer surplus elsewhere or else to receive its monetary equivalent. Both should equal, in terms of utility, the subjective value placed upon performance by the promisee. If, however, it is considered that there is no consumer surplus, the diminution in market value measure would be used. That amount would, in those circumstances, also provide the promisee with the equivalent amount of utility that performance would have. Where no substitute performance was available, which would be rare in the case of a contract of service, damages would have to be assessed through means other than the market to calculate the value of consumer surplus.[56]

3. Principles for Recognising a Consumer Surplus

The important question, therefore, is whether the promisee expects to attain utility from performance greater than the financial gain that would accrue from performance. That is where the inquiry into the measure of expectation damages begins; and in its most general application, built into the concept of consumer surplus, is the recognition that the basis for awarding cost of performance (or market value for that matter) is the parties' expectations. There are a number of factors which may be useful as a means of indicating what value the promisee placed on performance.

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53 As stated by Muris, "Cost of Completion or Diminution in Market Value: The Relevance of Subjective Value" (1983) 12 J Legal Stud 379 at 383: "At the least, however, courts should rely upon more objective indicators, given the difficulty of directly determining subjective intent solely through an individual's testimony."

54 As already mentioned, the law of remedies is mostly concerned with the interpretation of evidence.

55 Harris, Ogus & Phillips, supra at note 16, also discuss specific performance and equitable damages as ways the law has sought to compensate for a lost consumer surplus. The crucial question here is how common law damages can accommodate the concept of consumer surplus.

56 This point has more application to contracts for the sale and purchase of property.

(a) Price/consideration

The consumer surplus has been defined in terms of the excess utility obtained from a good which is above the utility associated with market price.[57] It follows, therefore, that where more money is tendered, higher utility is expected.[58] It is possible to go further and say that where market price only is offered there is no consumer surplus.

Against this analysis, Harris *et al* argue that a more important factor than contract price is the promisee's willingness to pay – particularly where there is a perfectly competitive market in which the agreed price would be more likely to reflect the market price than subjective value.[59] Simply because market price is offered does not mean that there is no consumer surplus. A consumer surplus may still exist although the agreed price paid is equal to market value; for example, when it is a buyer's market and the promisee is the buyer. Conversely, agreement to pay a price higher than market value may simply be an indication of a gross miscalculation, rather than expected utility. It would not be reasonable, in those circumstances, to saddle a defendant with the plaintiff's bad judgment.[60] Although, as Farnsworth suggests:[61]

> [T]he natural inclination is to favour 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.

It may be fair to attribute a consumer surplus to a person who agrees to pay a price higher than market value. What would not be fair, however, would be to insist that simply because the promisee has paid the market price he or she does not expect utility from performance beyond its market value.

Muris makes the novel point that payment of a price beyond that set by the market provides insurance against non-performance.[62] The point is reasonable; a higher price should provide *insurance* for the consumer surplus. The converse is also true; market price, while not cancelling out the possibility that a consumer surplus exists, will leave the promisee uninsured (so to speak) as to performance. He or she will have the onus of proving subjective value exists; it will not be guaranteed.

A further point made by Muris[63] is that it may be difficult to estimate the appropriate market price of an item in order to determine whether the promisee has agreed to pay in excess of that amount. The courts may have to assess the amount some time after the purchase. The performance may also be in a package of tasks

57 Harris, *Remedies in Contract and Tort* (1990) 45.

58 See Muris, supra at note 53, at 384: "Subjective value necessarily exists if the original price of the performance exceeds the value in the market of that performance to other potential purchasers."

59 See Harris, supra at note 57, at 45 n2: "A competitive market should ensure that its price is close to its cost".

60 Nor benefit the defendant with the plaintiff's good judgment.

61 See Farnsworth, supra at note 3, at 1170.

62 Supra at note 53, at 382-383.

63 Ibid, 386.

for which one price was paid. These problems are real and will serve to undermine the probity of the price-utility relationship.[64]

(b) Third parties

Another convincing piece of evidence that will support a plaintiff's claim to a consumer surplus is an obligation to obtain performance for a third party. If a promisee is obliged under another agreement to provide the performance offered by the promisor, the promisee will not be interested in the market value measure of damages; he or she will be primarily interested in the performance per se.[65]

In *Conquest v Ebbets*[66] it was held that when a lessee brings an action against a sub-lessee for breach of covenant to repair, it was legitimate to take account of the lessee's liability under the head lease to perform the same covenants. The issue of third parties was also influential in *Radford v De Froberville.* The fact that the plaintiff wanted to build for the benefit of a third party countered any possible suggestion that the plaintiff's motives in rebuilding were "merely capricious".[67]

It may seem odd that a promisee insists on cost of performance damages because of liability to a third party, when there is no obvious reason to expect that this liability to a third party will itself be assessed as cost of performance damages. Where that third party receives market value damages from the promisee for his or her failure to perform, surely market value damages from the promisor would provide adequate compensation.

This presumes, however, that there is a contractual obligation between the promisee and the third party. The obligation may simply be a moral duty, as between a parent and child. The importance of a promisee's obligations with third parties is not so much as a guide to what the promisee has lost, but as to whether the promisee valued performance per se. It may well be that where liability to a third party had already been assessed at market value, this would displace the inference that the promisee needed the promisor's performance more than the consequent capital gain. It would seem absurd, however, to have a trial within a trial to assess the quantum of that claim in order to settle the promisee's claim. In fact, a request to do that by the defendant in *Conquest v Ebbets* was denied.[68] It may be better to say that obligations to third parties raise a presumption of a consumer surplus, but are not conclusive of one.

There may be a situation, however, where the promisee is actually being forced to obtain performance. These cases, described as "extraneous coercion" in *Tito v*

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64 It should be borne in mind that whatever price has been paid, even if above market value, it will be recoverable in indebitatus assumpsit for total failure of consideration. The discussion above has most relevance to the situation where obligations are executory.

65 See *Murphy v The County Council of Wexford* [1921] 2 IR 230, 240 (CA).

66 Supra at note 49.

67 Supra at note 19, at 1285.

68 Supra at note 49, at 495; observed in *Tito v Waddell (No 2)*, supra at note 31, at 334, and in *Radford v De Froberville*, supra at note 19, at 1284.

Waddell,[69] may involve the enforcement of certain work by a local authority. It would obviously be wrong to award diminution in market value in those circumstances.

(c) Nature of contract

It can be argued that a particular type of contract may of itself indicate whether or not the plaintiff has a consumer surplus in the contract.

Construction contracts

In the case of buildings rendered defective by faulty design, the usual approach is to give the replacement value.[70] One commentator could find only one uniform principle emerging out of the construction cases:[71]

> This suggestion may explain the uniform application of the cost of completion rule in cases where the promisee is a governmental unit performing governmental functions, or a contractor letting out portions of his contract, or a railroad receiving a grant of land and promising to fence it in or construct a right of way; in all these cases, the recipients of the construction are interested only in the construction *per se*.

The same writer suggests that where the recipient is interested in the construction for its own sake rather than for any collateral gain arising from performance the courts incline toward cost of performance.[72] The same principle seems to be at work in the so-called New York "location of construction" rule. Where the construction does not take place on the promisee's property it is assumed that the only purpose of the construction is to increase market value for resale. Such a promisee would be content with damages assessed at market value. If, however, the construction does take place on the promisee's property, no inferences as to the parties' intent can be made. Assessment then becomes more difficult. The same commentator continues:[73]

> The ordinary type of construction case, where construction is on the promisee's land, is more difficult to fit into this principle because the inferences from merely reported facts to intent of the parties are vaguer. The principle is consistent with the objective theory of contracts, based as it is on the reasonable expectations induced in the parties to the transaction.

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69 Supra at note 31, at 333.

70 See *East Ham Corporation v Bernard Sunley & Sons Ltd* [1966] AC 406, 445 (HL) and *Bevan Investments v Blackhall & Struthers (No 2)* [1978] 2 NZLR 97 (CA). See also *Cooke v Rowe* [1950] NZLR 410 and the Court of Appeal's departure from the prima facie rule, as stated in *Bevan*, that cost of performance be given for defective work, in *Warren & Mahoney v Dynes*, supra at note 18. In that case the diminution in market value measure was *greater* than the cost of performance. In *Samson & Samson Ltd v Proctor* [1975] 1 NZLR 655, where the defendant's breach did not render the building defective, nor cause any loss to the plaintiff, who resold at an advantageous price, Macarthur J assessed damages as the difference in the cost of the actual work done and the work specified. This was a measure quite different from the cost of replacement or the market value and as such was not an expectation measure of damages at all. No real rationale was put forward for the decision.

71 See General Commentary on Recent Decisions "Contracts – Measure of Damages in a Grading Contract" (1940) 40 Colum L Rev 323.

72 Ibid, 325.

73 Ibid, 326.

Again, circumstantial evidence is not of itself a sufficient basis for forming a conclusion as to the existence of a consumer surplus. At best, a rebuttable presumption can be suggested. Where construction is not on the promisee's land, damages assessed as the diminution measure will be presumed adequate. Where the construction occurs on the promisee's land, however, the possibility of obtaining cost of performance damages is favoured but not finally resolved. More evidence will be needed as to the reason for construction, which will in turn provide evidence of the promisee's expectations.

Commercial vs consumer

Of a more general nature is the distinction made by Muris between what can be classed as business or commercial contracts and consumer contracts:[74]

> [M]aximizing wealth has high predicative power for the actions of business managers. On the other hand, non-pecuniary elements, such as sentimental value, often play a prominent part in consumer's decisions. Businesses often purchase for resale, making value to the buyer presumably a function of the item's price. Consumers typically buy, not for resale, but for use.

Muris concedes however that a firm also may buy to *use* rather than for capital gain. A firm may also value performance differently to the market, whereas the consumer may value it in the same manner. In the final analysis Muris considers that the distinction is most relevant to the allocation of proof:[75]

> When the consumer is the non-breaching party, the breaching party has the burden to show that only objective (market) value is relevant. When a business is the nonbreacher, it must show that subjective value is relevant.

This may be a fair distinction to make – but it goes too far to make it a rigid rule of evidence. The same end could be achieved, without such rigidity, by saying that in consumer-type contracts there is a presumption toward cost of performance, but in commercial contracts the presumption is toward market value.

(d) Election to seek specific performance

It can be argued that an election to seek specific performance is one way to demonstrate a subjective value in performance.[76] As a corollary to this argument, an election to sue for damages when specific performance was available provides evidence of indifference as to damages or performance and should lead to an award of market value damages. In *Wigsell v School for Indigent Blind*, Field J stated that:[77]

> [T]he plaintiffs, if they really wished to have the wall built in accordance with the contract ... might have claimed in the Chancery Division specific performance of the covenant .... The effect, however, of electing to bring the action for damages, is to convert the right to the performance of the contract into a right to have compensation in money, and the rule in such a case, stated in its most general terms, is that the plaintiff is entitled to have his damages assessed at the pecuniary amount of the difference between the state of the plaintiff upon the breach of the contract and what it would have been if the contract had been performed.

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74 Supra at note 53, at 382-383.

75 Ibid, 383.

76 See *Murphy v The County Council of Wexford* , supra at note 65.

77 Supra at note 49, at 363-364.

These findings were discussed at length in *Radford v De Froberville*, where Oliver J concluded that where an election was made to seek damages, as opposed to specific performance, no general rule applied but an inquiry into "what have you actually lost" began. In that regard, the election not to proceed with specific performance would be relevant but not determinative as to what the measure would be.[78] This was the same approach as that taken in *Tito v Waddell.*[79]

(e) Intention/undertaking to use damages to perform

Earlier it was noted that an intention to use damages to obtain substitute performance should not be the determining factor as to the quantum of damages. It was submitted that the English cases, at first instance, have placed the wrong emphasis on the parties' intention to perform. A more appropriate emphasis may be to adopt the view that an intention to perform, in an indirect way, can provide evidence of a party's intentions at the time of formation. It can however provide only a guide. It is a piece of circumstantial evidence of limited probative value that must be construed alongside other evidence of the parties' intentions.

(f) Alternative performance already obtained

It was held in *Tito v Waddell* that where the plaintiff has already obtained alternative performance that is conclusive grounds for giving the cost of performance, even if there is no duty to mitigate.[80] Briefly, as a discussion of this proposition is beyond the scope of this article, this must be doubted. To view alternative performance as conclusive grounds for giving cost of performance is to again look at circumstances which arise *ex post factis*. Having said that, however, it is submitted that the procurement of performance elsewhere will be of the highest probative effect in ascertaining the parties' intentions at formation. It is this difference in emphasis that distinguishes this analysis from that of *Tito v Waddell.*

(g) Did the promisor know of consumer surplus?

In his dissenting opinion in the *Peevyhouse* case Irwin J said:[81]

> The defendant had knowledge ... that the cost of performance might be disproportionate to the value or the benefits received by the plaintiff for the performance.

This raises the question of whether it will be necessary to ask whether the promisor knew that a consumer surplus in performance existed for the promisee. Muris considers the issue to be one of foreseeability:[82]

> Not only must the subjective value exist, it must also be foreseeable .... A defendant cannot be held to an unusual loss of the plaintiff unless, at the very least, he has, or should have, knowledge of the loss. Within the context of subjective value, the foresight requirement means that the party in

78 Supra at note 19, at 1280.
79 Supra at note 31, at 333.
80 Ibid, 332.
81 Supra at note 17, at 115.
82 Supra at note 53, at 383-384

> breach must have some knowledge of the circumstances (usually from communication with the innocent party) that make it likely that breach will cause subjective losses. Only if courts apply the foresight requirement will the party with knowledge of the special circumstances have the proper incentive to guard against the loss, including disclosing the problem to the other party, which may then be paid a premium to assume the additional risks.

For Muris this seems to be a *Hadley v Baxendale*[83] issue. This, it is submitted, may not be the correct analysis. Todd[84] considers that the rule in *Hadley v Baxendale* defines the *type* of damage for which the plaintiff must receive recompense. In other words, the analysis differentiates between remote and proximate losses. It is only then that a second issue arises: what is the measure of damages needed to compensate for losses defined as sufficiently proximate? As it has been stated:[85]

> This rule does not come into play with regard to any claimed head of damage until it has been determined by the rule as to remoteness, whether that head of damage can be brought into consideration at all.

It will not be necessary, therefore, to show that the promisor knew what valuation was placed on performance by the promisee. As long as the *loss of position* suffered from non-performance was a natural consequence of a breach, or was known by the promisor to be a possible consequence, such a loss will not be too remote. The valuation of that position, that is the measure of damages, is a separate question. The ruling principle when it comes to the measure of damages is *restitutio in integrum* – not remoteness.

The promisor will of course need to have known of the *terms* of the contract; the parties will need to have reached a *consensus ad idem* for the contract to be validly formed. But as discussed, the terms of the contract will not always be indicative of expectations; knowledge of terms will not necessarily equate with knowledge of the promisee's expectations.

(h) Conclusion to principles for recognising consumer surplus

There is nothing particularly conclusive about any of the considerations mentioned above when it comes to assessing the expectations of the promisee at formation. Nor is the list exhaustive. No apologies should be made for this. The assessment of intention is not, nor should be, an exact science. The above principles do, however, provide some guide which demonstrate how the rule in *Robinson v Harman* should be applied when faced with a discrepancy between the market value and the cost of performance.

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83 (1854) 9 Exch 341.

84 Burrows, Finn & Todd, *Cheshire & Fifoot's Law of Contract* (8th NZ ed 1992) 654.

85 *The Argentino* (1888) LR 13 PD 191, 196 per Esher MR.

V: BIRKS' ALTERNATIVE TO THE CONSUMER SURPLUS APPROACH

Birks considers that the approach of trying to return the cost of performance to the plaintiff as a compensatory measure, particularly via the consumer surplus analysis, is unnecessary:[86]

> Harris, Ogus and Phillips have ... proposed a way in which it might be overcome without abandoning exclusive reliance on the compensatory principle. Expectation damages ... should, they say, include a sum for the loss of the plaintiff's "consumer surplus", the subjective value, over and above, the market value, which the plaintiff accorded to completion.[87] This subtlety is not necessary;[88] open recognition of the possibility of restitutionary damages would give the plaintiff the enrichment of the defendant – ie., the saving made by him in not keeping his promise – and would do so without exacting the unreal proof of an intention to get the work done. This has been done in New Zealand and is the solution approved by Jones.

The New Zealand case referred to is *Samson & Samson Ltd v Proctor*.[89] In that case the defendant failed to use the specified amount of steel in building foundations. The plaintiff sought and received as damages the amount saved by the defendant through this breach of contract. In Birks' view, therefore, cases like *Tito v Waddell* and *Radford v De Froberville* are all examples of where the defendant has saved money through non-performance and, as in the case of *Samson & Samson*, that saving can be restored to the plaintiff in the form of restitutionary damages for breach of contract. Where the cost to perform a contract is more than its end value, a defendant will save money by non-performance. Using the market value construct,[90] the plaintiff will have lost nothing. However, Birks argues that it may be possible to strip the defendant of savings made because of the breach, by abandoning claims for expectation losses and seeking recovery of the defendant's unjust enrichment.

This measure of contract damages awarded in *Samson & Samson* may, however, be subject to a number of objections. It suggests a quantum of damages somewhat different from that espoused by Fuller and Perdue in their seminal analysis of the "restitution interest".[91] In their terms, where the *plaintiff in reliance on a contract confers some benefit on the defendant*, and if the defendant breaches, he or she will be required to disgorge the benefit; the object being the prevention of unjust enrichment. Fuller and Perdue never deviate, therefore, from the earliest expression of contract damages: that the main focus is not on what enrichment a

86 Supra at note 9, at 432.

87 Harris, Ogus & Phillips, supra at note 16.

88 See for example *British Motor Trade Association v Gilbert* [1951] 2 All ER 641 (Ch D), a case which illustrates, according to Birks, supra at note 9, at 430: "[the] intellectual contortions by which a restitutionary award can be presented as compensatory".

89 Supra at note 70.

90 Birks seems to uphold a view that compensatory damages should always be assessed at market value.

91 Fuller & Perdue, "The Reliance Interest in Contract Damages" (1936) 46 Yale LJ 52, 54; approved in *Newmans Tours Ltd v Ranier Investments Ltd*, supra at note 7, at 86.

defendant has gained from breach per se, but *on what the plaintiff has lost*. The reason the restitution interest represents an *a fortiori* claim to contract damages is that not only has the plaintiff lost something, but this very same loss has accrued to the defendant.[92] Only where a plaintiff has conferred a benefit on the defendant will a restitution interest have been formulated.

The main objection, therefore, that might be thought to exist in relation to restitutionary damages, as espoused by Birks, is that traditionally at common law a plaintiff could seek restitution only where there was a concomitant loss to the plaintiff. In *Lamine v Dorrell*,[93] where a trespasser made a profit from his tort, disgorgement of those gains from the defendant to the plaintiff was denied. It was argued that the defendant had merely saved himself the price for using the land, and as such the amount was not recoverable in restitution. Birks considers that this bar to restitution for savings was simply a matter of policy which no longer has merit. As he puts it:[94]

> Just as in *Moses v Macferlan*[95] is the contract case comparable to *Lamine v Dorrell* in tort, so these cases, where the plaintiff would be claiming a negative enrichment – money not expended – are comparable to *Hambly v Trott*[96] and *Lightly v Clouston*.[97] The objection once made that negative enrichment is not amenable to actions for restitution is manifest nonsense.

With respect, Birks' view of the *policy rule* against recovery of negative enrichment must be correct. However, what does not follow from acceptance of his point is a dismissal of the requirement that such enrichment be at the plaintiff's expense. In *Lamine v Dorrell*, for example, the defendant was disgorged of money saved by trespassing on the plaintiff's land without paying for it. Admittedly, that amount can be characterised as a negative enrichment, inasmuch as the defendant saved money rather than made profits. The point is, however, that the money saved was *owed to the plaintiff*. The defendant subtracted from the plaintiff the *use* of the land without paying for it; the enrichment was therefore at the plaintiff's expense.

Characterising the amount saved by the defendant as a negative enrichment becomes confusing. The defendant received something which belonged to the plaintiff. In that sense the enrichment can equally be regarded as a positive one. The price charged for using the land is simply the valuation of the enrichment.[98] So the reason the bar against negative enrichment was lifted in the tort cases was that, in accordance with concepts of proprietary ownership, a situation involving

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92 Unlike expectation and reliance losses where the plaintiff's losses will not necessarily enrich the defendant.

93 (1701) 2 Ld Ray 1216; 92 ER 303.

94 Birks, supra at note 9, at 433.

95 (1760) 2 Burr 1005; 97 ER 676.

96 (1776) 1 Cowp 371; 98 ER 1136.

97 (1808) 1 Taunt 112; 127 ER 774.

98 The same principle was applied in relation to chattels in *Strand Electric & Engineering Co Ltd v Brisford Entertainments Ltd* [1952] 2 QB 246 (CA), where the defendant had converted the plaintiff's electrical equipment. The plaintiff was awarded the price of hiring the equipment as damages for detinue.

free use of property could also be characterised as representing a positive enrichment to the defendant.[99]

Both of these tort cases are examples of a situation quite different to *Samson & Samson.* The difference with contract cases, as opposed to the tort cases, is that where the plaintiff has paid nothing for contractual performance, any savings made by the defendant cannot be analysed as a loss to the plaintiff. Nothing that can be considered to be owed or owing has been subtracted from the plaintiff.[100] Unlike the defendant in *Lamine v Dorrell,* the defendant in *Samson & Samson* did not receive anything that could be considered a positive enrichment. He was merely saved the cost of doing work. The only way that this amount could be considered a loss to the plaintiff would be if the cost of doing the work was greater than the market value, and the plaintiff therefore had a consumer surplus in performance. This would return the argument to "square one" – needing to assess the expectation measure. It would also have created a situation where it could be said that whenever there is a breach of contract, the plaintiff's loss will equal a saving to the defendant and, therefore, restitution of that amount should be given to the plaintiff. That kind of confusion could never have been intended by Fuller and Perdue in their formulation of the restitutionary interest.

The crucial problem, therefore, with recovering savings, whether in contract or tort, is not a procedural bar but a substantive requirement (without which *indebitatus assumpsit* would be senseless) that there should be a subtraction from the plaintiff's assets, and that the defendant should only be stripped of gains made by breach where there is a concomitant loss to the plaintiff. Thus, only where a saving is *at the plaintiff's expense* will it be available as restitutionary damages. Where there is no concurrent loss to the plaintiff, relief has traditionally been denied. The only real possibility of disgorging a defendant's enrichment where there has been no loss to the plaintiff would be equity's account of profits,[101] but that also arguably requires an accretion to the defendant's assets, not just a saving.

VI: CONCLUSION

As was acknowledged from the outset, it is inherently difficult to place a person in the position he or she would have occupied had the relevant contract been performed. In the case of contracts for services, there is at times a discrepancy between the cost of performing a service and the market value of the end product. It becomes difficult in those circumstances to decide which amount would best

99 And in a converse way any other case of what would usually be regarded as a positive enrichment can also be characterised as a negative one. For example, those who steal a trademark and profit from doing so have also saved themselves the price of buying the trademark.

100 See *City of New Orleans v Fireman's Charitable Assoc* 9 So 486 (1891), cited in Goff & Jones, *The Law of Restitution* (3rd ed 1986), where firemen saved money by not keeping men available as contracted. The saving in cost was not available as damages because no loss was suffered. Failure to perform could, however, have amounted to total failure of consideration.

101 For example on the facts in *Lumley v Wagner* (1852) 1 De GM & G 604; 42 ER 687.

fulfil the promisee's expectations.

It has been suggested that a number of the judicial and academic responses to this problem have been unsatisfactory. In these various approaches there has been one fundamental flaw – the failure to take account of what actual (rather than assumed) expectations existed in the minds of the parties at the time of formation.

The simple approach is therefore to ask which measure of damages best equates with the expectations of the parties. Using the consumer surplus approach, a distinction can be made between persons who value performance as a means to an end, and those who value it as an end in itself. Where a contract is entered into as a means of financial gain, the market value measure is indicated. Where, however, the contract is seen as an end in itself, the cost of performance is indicated. It becomes then a matter of looking at the evidence to see which of these measures will best account for the utility expected from performance and as such provide *restitutio in integrum* for the disappointed promisee.