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Article

Private Advantage and Public Power: Reexamining the Expectation and Reliance Interests in Contract Damages

by

MARK PETTIT, JR.*

Introduction

Fifty years ago Fuller and Perdue asked why it is that in cases of breach of contract courts usually award "expectation" damages rather than "reliance" damages.¹ The authors defined these damages measures by their purposes.² The object of the expectation measure "is to put the plaintiff in as good a position as he would have occupied had the defendant performed his promise."³ The object of the reliance measure, on the other hand, is to "undo the harm" caused by reliance on a promise that was later broken, that is, "to put [the plaintiff] in as good a position as he was in before the promise was made."⁴ Fuller and Perdue concluded

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1. Fuller & Perdue, *The Reliance Interest in Contract Damages* (pts. 1 & 2), 46 *YALE L.J.* 52, 373 (1936-37).

2. *See id.* at 52-53.

3. *Id.* at 54.

4. *Id.* I prefer to define the reliance measure as the attempt to put the plaintiff in the position he would have occupied had he not contracted with the defendant. My preference for this language over the definition offered by Fuller and Perdue is that focusing on the "status quo ante" may cause us to overlook the harm resulting from opportunities lost by the plaintiff by reason of the defendant's promise. *See infra* text accompanying notes 10-11. It should be pointed out, however, that Fuller and Perdue themselves recognized that lost opportunities are an important form of reliance loss. *See Fuller & Perdue, supra* note 1, at 55, 60.

The object of the third measure (restitution) is "the prevention of gain by the defaulting promisor at the expense of the promisee; more briefly, the prevention of unjust enrichment." *Id.* at 54. This Article is concerned primarily with a comparison of the expectation and reliance measures, and does not explore the uses of the restitution measure. For a recent discus-

that the strongest reason for protecting the expectation interest is that, as a practical matter, it is the best way to protect the reliance interest. In other words, protection of the expectation interest is not actually the goal, but merely the best means of protecting and promoting reliance.⁵

In the more recent past, commentators have advanced economic and moral arguments to support expectation protection as the desired goal of contract damages, and not simply as the best means of protecting reliance. Most recently, Melvin Eisenberg, alone⁶ and with Robert Cooter,⁷ has staked out something of a middle ground, arguing that reliance protection is an important, but not exclusive, justification for expectation damages.

This Article concludes that all the arguments that have been offered to justify the expectation principle independently of reliance protection are unpersuasive. This conclusion is based on a close analysis of the concepts of expectation and reliance and the difference between the two ideas. Section I of the Article attempts to demonstrate that the only expectation loss not covered by the reliance measure is the loss of what I call the "extra advantage" that the promisee would have received from the defaulting promisor's performance beyond what he would have received from any other contracting party. What follows from this observation depends not upon logic, but upon one's political and moral values. I conclude for my own part that public power should not be used to enforce the private advantage of expectation unless there is some compelling reason to do so. In other words, the burden of proof should be on the party seeking to employ state power. Unless it can be shown that protecting the expectation interest will make us richer or more just or more free, we should stop after we have protected the reliance interest.

In the next section, the Article, like the Fuller and Perdue article fifty years ago, examines contemporary arguments for expectation protection as the goal itself, rather than merely as the means to achieve the goal of reliance protection. Although current moral and economic arguments may be more sophisticated than those addressed by Fuller and Perdue, they still do not make a convincing case for going beyond compensation for loss in order to effectuate gain.

But what if we are faced with the somewhat unusual situation in which reliance loss exceeds lost expectation? Should we then make ex-

sion of the restitution and expectation interests, see Farnsworth, *Your Loss or My Gain? The Dilemma of the Disgorgement Principle in Breach of Contract*, 94 YALE L.J. 1339 (1985).

5. Fuller & Perdue, *supra* note 1, at 60-62.

6. Eisenberg, *The Bargain Principle and its Limits*, 95 HARV. L. REV. 741 (1982).

7. Cooter & Eisenberg, *Damages for Breach of Contract*, 73 CALIF. L. REV. 1432 (1985).

pectation rather than reliance the presumptive choice? Would choosing expectation here betray an inconsistency in approach? Section III explores these questions.

Section IV moves from the theoretical to a more practical realm, and explores the best method for achieving the goal of reliance protection. The difficulties of measuring true reliance loss tend to support the conclusion of Fuller and Perdue that the expectation measure usually is the best way to protect the reliance interest. The Article suggests, however, three types of situations in which courts should consider departing from the expectation measure.

I. Distinguishing the Concepts of Expectation and Reliance

As defined by Fuller and Perdue, the expectation and reliance measures attempt to do two different things. Expectation seeks to approximate performance of the promise, and reliance seeks to remove all effects of the promise and its breach. But two factors cloud the apparently clear distinction between the two measures. First, the loss of an expected benefit itself usually involves some reliance loss. If I promise my children a trip to an amusement park and then repudiate my promise a minute later, they will feel worse than if I had not mentioned the trip at all.⁸ To undo all the harm caused by my broken promise, I would have to compensate them for the unhappiness and sense of injury I caused when I created an expectation and then destroyed it.⁹

8. Most of the discussion in this Article concerns exchange promises made in the business or commercial setting. The reason for this emphasis is that it is generally believed that the commercial exchange promise provides the strongest case for the expectation measure, *see, e.g.*, Cooter & Eisenberg, *supra* note 7, at 1459-75; Eisenberg, *supra* note 6, at 743-44, 799; Fuller & Perdue, *supra* note 1, at 62-63, 373, and I want to address the strongest arguments for expectation damages. Nevertheless, the example of my promise to my children is an intrafamilial gift promise that is about as far removed from a commercial exchange as is possible. I have departed from the commercial setting to use this example because it illustrates more clearly the "psychological harm" problem. *See id.* at 57-58. This type of psychological harm would seem to be less of a concern in a commercial exchange setting.

9. Fuller and Perdue argue that compensation for psychological harm cannot explain protection of the expectation interest because psychological harm attends all broken promises, but the law does not award expectation damages for all broken promises. Fuller & Perdue, *supra* note 1, at 57-58. Notice, however, that even a traditional expectation award would not completely eliminate the psychological harm problem, although it would usually reduce the problem substantially. In the example, even if I give in and bring my children to the amusement park or take them somewhere else that they like as much, they will have suffered some disappointment that they would not have experienced if I had simply kept my promise in the first place. Bringing them to the park will not completely compensate them for their temporary disappointment, although, once they go to the park, they probably will not dwell on the repudiation that occurred between the time of the promise and the time of performance. My point here is simply that full protection of the reliance interest (*i.e.*, placing the promisee in the

Although it may be possible to compensate fully for this kind of disappointment without providing the equivalent of full performance, attempting to do so poses intractable measurement problems. Once I have promised my children the amusement park trip, they will say that nothing will satisfy them but a trip to the amusement park or something else that they like as much as that trip. But actually going to the amusement park will put them in a better position (in their view) than if I never had made the promise. Measuring the reliance loss requires answering the awkward and unsatisfactory question—for what price would my children be willing to suffer a broken promise to go to the amusement park? The mere mention of the park will start them howling to go there. This homespun example suggests that the psychological harm accompanying disappointed expectations can make it difficult, if not impossible, to quantify the difference between the theoretical concepts of expectation and reliance; it does not suggest, however, that the two concepts are the same.

The second complication in distinguishing the concepts of expectation and reliance emerges from the recognition that reliance loss may include lost opportunities as well as out-of-pocket losses and expenditures.¹⁰ If, because of your promise, I lose an opportunity to earn a \$100 profit from another contract, I must recover \$100 in damages (discounted according to the probability of realizing that opportunity)¹¹ to be placed in the same position I would have been in had you not made your promise. This lost opportunity fits the Fuller and Perdue definition of reliance just as well as does money spent by the promisee in reliance on the fulfillment of the promise.

In fact, both the expectation measure and the reliance measure involve the concept of lost opportunity. Lost expectation encompasses the value of the opportunity that was created by the formation of the contract and was then lost by its breach. Reliance loss includes the value of an opportunity that existed apart from the contract and was then lost by formation of the contract. In other words, one way to think about the

position he would have been in had there been no promise) would require compensation for the sense of injury or disappointment caused by a breach of promise.

10. Fuller and Perdue recognize that the concept of reliance loss includes forgone opportunities. *See id.* at 55, 60; *see also* *Dialist Co. v. Pulford*, 42 Md. App. 173, 399 A.2d 1374 (1979); Cooter & Eisenberg, *supra* note 7, at 1440-41; Eisenberg, *supra* note 6, at 744 n.10; Goetz & Scott, *Enforcing Promises: An Examination of the Basis of Contract*, 89 *YALE L.J.* 1261, 1269 (1980).

11. Such discounting is necessary as a theoretical matter to avoid placing the promisee in a better position than he would have been in had the promisor made no promise. I will argue later, however, that as a practical matter there should be a presumption against this discounting. *See infra* note 136.

distinction between the expectation and reliance measures is to distinguish the causes of expectation and reliance losses. Expectation losses are caused by the breach of a promise: but for the breach there would be no expectation loss.¹² Since the expectation measure is a measure of damages for breach of contract, it seems to be a statement of the obvious that the cause of the damages was the breach.

What may not be obvious is that most reliance losses are not caused by breach, even though we speak of reliance damages as an alternative remedy for breach of contract.¹³ Opportunities lost because of reliance on a contract, as well as most out-of-pocket reliance expenditures, result from the formation of a contract, but not from its breach.¹⁴ These losses would have occurred even if the defaulting party had fully performed her¹⁵ contractual obligations. The nondefaulting party incurred these losses before the time of breach with no expectation of reimbursement; rather, he hoped that the sum of these losses would be less than the sum of the gains he would receive from the other party's performance. Although we can say that the subsequent breach provides the occasion for the recovery of these reliance losses (and that the breach caused the award of reliance damages), we cannot say that the breach caused the losses.¹⁶

Although reliance and expectation involve different lost opportunities, sometimes the two opportunities may be of equal value to the prom-

12. Of course, for a promise to be broken, it must be made in the first place. In this sense, it might be more accurate to say that expectation losses are caused by the making and subsequent breaking of a promise. The point is simply that without a breach there is no expectation loss.

13. Reliance losses not caused by breach include: 1) opportunities forgone by choosing to enter into the contract, and 2) out-of-pocket expenditures made before breach occurs. Since expectation damages are limited to damages caused by breach, these items are not recoverable under an expectation measure.

Some reliance losses are caused by breach. For example, litigation costs are incidental to breach and must be recovered to put the promisee in the position he would have occupied had there been no contract. Some damages suffered as a consequence of breach of warranty can constitute reliance losses. Fuller and Perdue cite the case of the sale of a cow, warranted to be free from disease, that infects the buyer's whole herd. See Fuller & Perdue, *supra* note 1, at 75. These incidental and consequential damages caused by breach must be recovered to protect either the expectation interest or the reliance interest. See *infra* note 119 for the Uniform Commercial Code definitions of incidental and consequential damages.

14. See *Kinzley v. United States*, 661 F.2d 187, 193 (Ct. Cl. 1981), for one court's recognition and discussion of this point.

15. For purposes of clarity, throughout this Article I use the masculine pronoun to refer to the plaintiff-promisee and the feminine pronoun to refer to the defendant-promisor.

16. I am talking here about causation in a factual sense, not in a legal sense. The test of causation in fact is often stated as the "but for" test. But for *A*, *B* would not have happened. See *infra* note 111.

isee. If the promisee had two identical opportunities, and flipped a coin to choose the contract with the defendant-promisor, then the reliance and expectation losses would be the same. In other words, if the value of the forgone opportunity equals the value of the contract opportunity, the promisee must recover the full value of the defendant's promised performance to be placed in the same position that he would have been in had the defendant made no promise.

Under what circumstances will the forgone opportunity equal the contract opportunity? Professor Eisenberg has provided a helpful exploration of this question in a recent article.¹⁷ Briefly stated, Eisenberg's answer is that when promises are made in a perfect market—that is, a market with such characteristics as complete information, continuity, depth, and homogeneous commodities—the promisee is indifferent about whom he deals with; every contract in the perfect market is identical.¹⁸ Of course, few, if any, markets are perfect. To the extent that the promisee has a reason to choose a particular promisor, the expectation loss will exceed the reliance loss.

The difference, then, between the expectation interest and the reliance interest is the difference in value to the plaintiff of (1) the contract he formed with the defendant and (2) the alternative contract (if any) the plaintiff would have formed with someone else had he not contracted with the defendant. It is in this sense that the expectation interest is said to give the promisee the "benefit of the bargain."

Professor Eisenberg suggests that one reason for awarding expectation damages is to give effect to the parties' allocation of the risk of price changes. He asserts that considerations of efficiency and fairness normally support effectuating this allocation, "and that is just what is done by expectation damages."¹⁹ But the difference between expectation and reliance damages is not that expectation gives effect to the allocation of risk of price changes and reliance does not. To illustrate, consider the following hypothetical used by Eisenberg: a buyer breaks a contract for purchase from a dealer of a quantity of standard typing paper for \$4000.²⁰ Assume that the market price²¹ on the date that seller learns of

17. Eisenberg, *supra* note 6, at 785-98. Cooter and Eisenberg extend Eisenberg's earlier analysis, using more formal methods of economic analysis. Cooter & Eisenberg, *supra* note 7, at 1444-59.

18. See Eisenberg, *supra* note 6, at 746-47.

19. *Id.* at 787.

20. See *id.* at 791.

21. Professor Eisenberg uses the broader term "replacement price," which he defines as "the price payable under a substitute contract." *Id.* at 788. Replacement price may be established by market price or by actual substitute purchase (cover price) or substitute sale (resale

the breach²² is \$3500. Assume also that the forgone price²³ is the same (\$4000) as the contract price (as Eisenberg suggests would be the case for homogeneous goods like standard typing paper).²⁴ In this case, the expectation measure (contract price minus market price) and the reliance measure (forgone price minus market price) are the same (\$500).

What happens when the forgone price diverges from the contract price? Assume that the contract price is \$4000 but the forgone price is \$3800.²⁵ In this case, expectation damages still would be \$500 (\$4000 minus \$3500) but reliance damages would be only \$300 (\$3800 minus \$3500).²⁶ Which figure represents the amount of market movement? The answer depends upon whether the contract price (\$4000) or the forgone price (\$3800) is considered to be the market figure at the time of contract formation. The choice depends on one's definition of market price and perhaps on the facts of the particular case. For example, if the seller is selling a unique good, one might define the market price as the amount of the highest bid; on the other hand, if the object of the sale is not unique (as in the typing paper example), one might conclude that the buyer's offer to pay \$200 more than he would have to pay elsewhere reflects an error by the buyer about what the true market price is.²⁷

Although the problem is a definitional one, it seems sensible to think of the risk of market movement as the risk that price conditions in-

price). I am assuming here that the seller did not resell, and thus I am employing the market price.

22. Eisenberg argues that "replacement price" (in our example, market price) should be the price, on the date the innocent party learns of the breach, for delivery on the date specified in the original contract. He recognizes that the U.C.C. § 2-708(1) (1978) would measure the replacement price "at the time and place for tender." Eisenberg, *supra* note 6, at 788 n.126. Making the time that the innocent party learns of the breach the crucial time for determining damages seems to be consistent with both the theoretical concepts of expectation and reliance and the duty of the innocent party to mitigate damages.

23. Eisenberg defines "forgone price" as "the best price that was available from an alternative buyer or seller on the date of the contract (or, in appropriate cases, between the contract date and the breach date)." Eisenberg, *supra* note 6, at 788.

24. Under Eisenberg's assumptions of a perfect market and homogeneous goods, the forgone price and the contract price are the same. *See id.* at 789.

25. Presumably, in a perfect market with perfect information, the forgone price would never diverge from the contract price. In the real world, however, contract prices can diverge from existing market prices even when the market generally is functioning fairly well. In our example, the seller is getting a better price (\$4000) from this particular buyer than he could have obtained elsewhere (\$3800).

26. Expectation damages are \$500 because the seller would have received \$4000 had the buyer performed under the contract, but now the seller can get only \$3500 for the paper. Reliance damages are \$300 because if there had been no contract with the buyer in the first place the seller would have sold for \$3800. Now he can get only \$3500.

27. *See generally* R. PERLMAN, *THEORY OF MARKETS* 2-7 (1972); J. SINDEN & A. WORRELL, *UNPRICED VALUES: DECISIONS WITHOUT MARKET PRICES* 43-45 (1979).

dependent of the contract will change.²⁸ The market price at the time the seller learned of the breach (in our example, \$3500) is determined primarily without regard to the price established by the contracting parties; it is set by what others are willing to pay at that time. If the market price of typing paper at the time of contract formation similarly is determined independently of the contract price agreed to by this particular buyer and seller, the reliance measure (in the example, \$300), not the expectation measure (\$500), serves as the allocator of the risk of market movement. The extra \$200 included in the expectation award represents the amount by which the contract price of the typing paper exceeded the market price of such paper at the time the parties formed the contract. Thus, the risk that is allocated by the expectation measure, and not by the reliance measure, is the risk that the contract price differs from the existing market price. Under an expectation measure, the seller bears the risk that the contract price is less than the market price, and the buyer bears the risk that the contract price is greater than the market price.²⁹ This risk is not the risk of market movement, but rather the risk of "market deviation."³⁰

The typing paper example illustrates that when there is a functioning market for the subject matter of the contract we may conclude that the forgone price is the market price at the time of contract formation. But the difference between the expectation and reliance measures is the difference between the contract price and the forgone price, and that is a difference that can be determined without characterizing either price as a "market price." Consider the following hypothetical involving an item for which it may be difficult to denominate a "market value": A photographer goes to a road race and takes pictures of the runners as they cross the finish line. After the race, he contacts the people whose pictures he has taken and offers to sell them the pictures for \$10 each. Assume that one runner agrees to purchase a picture, but then repudiates her promise shortly thereafter. Presumably in this case only the runner (and possibly

28. One of Eisenberg's criteria for a "perfectly competitive market" is that the market share of each of the participants in the market is "so small that none can affect the commodity's price." Eisenberg, *supra* note 6, at 746 & n.13 (citing E. MANSFIELD, MICROECONOMICS 196-97 (3d ed. 1979)).

29. If the forgone price exceeded the contract price in the example (*e.g.*, the forgone price was \$4100), the expectation measure would fall short of allocating the risk of market movement. The amount of the shortfall would be the amount by which the seller undersold the market (\$100). See *infra* section III.

30. Eisenberg makes a brief reference to "the risk of misjudgment of market value." Eisenberg, *supra* note 6, at 790. I prefer to use the phrase "market deviation" rather than "market misjudgment" because it is broader and more neutral about the cause of the divergence between contract price and market price.

family members or friends of the runner) would pay any money at all for this particular picture. The photographer has not lost any alternative opportunity to sell the picture. Reliance damages would cover only expenditures incurred after the promise was made.³¹ Expectation damages would be the \$10 price, minus any developing and printing costs saved by the photographer as a consequence of not having to perform his part of the bargain. We do not have to identify the contract price (\$10) or the forgone price (\$0), or any other price, as the "market price" to distinguish between the expectation and reliance measures. Whether the subject matter of the contract is a fungible commodity such as typing paper or a unique item such as a photograph, the difference between the expectation and reliance measures can be stated in the same terms. The difference is that only the expectation measure preserves for the plaintiff the extra advantage he would have received from the defendant's performance beyond what he would have received from anyone else.

Once the nature of the distinction between the theoretical concepts of expectation and reliance is understood, we can begin to ask which measure should serve as the ideal goal of the law of contract remedies. The proposition that the power of the state should protect at least the reliance interest of a person who is the victim of a broken promise seems to be relatively uncontroversial. Even here, however, there may be exceptions, such as when the promisor has a good reason for not keeping her promise, or when the type of promise involved is deemed not to be one of sufficient public concern, or when the harm is deemed to have been avoidable by the promisee. But in cases of breach of exchange promises without excuse, few would argue that the promisor should not be forced at least to restore the promisee to the position he would have occupied had the promisor not made and broken her promise. Although philosophers may struggle with the question of why there is a moral obligation to keep a promise,³² if you have injured someone by making and

31. Reliance expenditures made before the promise (cost of film, photographer's time and lost opportunity to take someone else's picture, developing costs, if any) theoretically would not be recoverable since they would have been made even if the runner had never made the promise to buy. Some courts have awarded prepromise reliance, however. *See, e.g., Hoffman v. Red Owl Stores, Inc.*, 26 Wis. 2d 683, 133 N.W.2d 267 (1965); *Anglia Television Ltd. v. Reed*, [1972] 1 Q.B. 60 (C.A. 1971). As a practical matter, if a court is unwilling or unable to compensate the plaintiff for opportunities lost as a result of contracting with the defendant, it may make sense at least to award compensation for precontractual expenditures on the grounds that had the defendant not made her promise the plaintiff would have entered into an alternative contract that would have covered his precontractual expenses.

32. A century ago, David Hume argued that "a promise wou'd not be intelligible, before human conventions had establish'd it; and . . . even if it were intelligible, it wou'd not be attended with any moral obligation." D. HUME, *A TREATISE OF HUMAN NATURE* 516 (L.A.

breaking a promise to him without excuse, the fact of injury itself can supply a basis for a societally imposed obligation to make amends. If the very reason that the promisor used the language of promise was to induce reliance by the promisee, responsibility to protect the promisee when the promisor's actions turned that reliance into injury seems strong.

What is the justification for requiring the defaulting promisor to protect the promisee's expectation interest? Why should the law force her to pay to the promisee more money than is necessary to compensate him for all loss suffered as a result of contracting with her? Why should the law choose as its goal the monetary equivalent of full performance of a contract that is more favorable to the promisee than any contract he would have obtained elsewhere? As Fuller and Perdue³³ and Eisenberg³⁴ point out, protecting the promisee's expectation interest may be the best way to protect his reliance interest. I will explore this idea in section IV. But here, the question is whether there is justification for making protection of the expectation interest the goal of contract remedies rather than simply a means to achieve the goal of protecting reliance.

Logic does not resolve the choice between reliance and expectation. Complete protection of the promisee's reliance interest (including lost opportunities) would mean compensation for all losses suffered by the promisee by reason of the promisor's conduct from promise through breach. If the starting point from which to measure loss is the promisee's status at the time the promise was made, then reliance damages provide full compensation, and expectation damages are supercompensatory. But advocates of the expectation measure can also claim the compensation principle. If the starting point for measuring loss is the value of the promise, then the expectation measure provides no more than exact compensation for actual loss.

What should be the base level from which losses are measured? Expectation supporters can point out that it is the breach alone and not the initial promise that is the wrong to be compensated for. If no wrong had been committed (the promise had been kept), the promisee would have been in, say, position *X*. Because of the wrong the promisee is in position *Y*. Compensatory damages, therefore, should be *X* minus *Y*. Reliance

Selby-Bigge ed. 1888). Professor Fried reacts to Hume and provides an interesting discussion of the nature and sources of the moral obligation to keep a promise in C. FRIED, *CONTRACT AS PROMISE* 14-17 (1981).

33. Fuller & Perdue, *supra* note 1, at 60-62.

34. Cooter & Eisenberg, *supra* note 7, at 1461; Eisenberg, *supra* note 6, at 787.

supporters can reply that expectation is a strange kind of compensation because in fact the promisee never actually occupied position *X*. Expectation damages make the promisee better off than the promisee had ever been before. By using the time of promise as the starting point we can take account of the effect of all the actions of the promisor—you cannot break a promise without making it first. Reliance supporters can argue that their measure makes contract remedies consistent with tort remedies, so that we have one compensation rule for breaches of civil obligations.³⁵ Expectation advocates can counter that the presence of a promise makes contract different from tort, and uniformity would mean treating unequal things equally.

Although the choice between the expectation and reliance principles cannot be resolved by purely analytic means, the analysis of the difference between the two measures helps to clarify what is and what is not at stake in making the choice. That difference is what I have called the “extra advantage” that the nondefaulting party would have received from the defaulter beyond what he would have obtained elsewhere; the contract may have provided for this extra advantage for many different reasons. My own view is that implementation of this private advantage is not a proper use of the power of the state.

Critics might respond that as long as no one has exploited an improper advantage (for example, by exertion of vastly superior bargaining power, deception, duress, or the like) there is no reason why the extra advantage should not be enforced. My view is that, even when the bargaining process displays no identifiable flaw, this kind of private advantage should not become an object of state enforcement. There is no doubt that my view reflects certain fundamental philosophical and political biases. My conclusion reflects an underlying belief that, more often than not, it is the stronger actors in our society who seek to employ state power to enforce this privately negotiated “extra” advantage.³⁶ This be-

35. Professor Atiyah argues that contract damages are not unique in protecting expectations. He refers to the protection of future earnings and other forward-looking remedies in tort law. But these tort remedies seem to me to be reliance-type awards even though they look to the future. The question they address is how much money is needed to put the plaintiff in the position he would have been in had there been no tort. To figure this amount, some predictions about the future are necessary. Expectation damages in contract, on the other hand, uniquely seek to lock in the benefit promised by the defendant, making the plaintiff better off than if there had been no promise in the first place. See Atiyah, *Comments on Professor Waddams' Paper*, 8 CAN. BUS. L.J. 10, 14 (1983).

36. Atiyah and others have opined that “freedom of contract” helps the economically strong at the expense of the weak. P. ATIYAH, *THE RISE AND FALL OF FREEDOM OF CONTRACT* 648, 702 (1979) (citing Lord Diplock’s opinion in *A. Schroeder Music Publishing Co. v. Macaulay*, [1974] 3 All E.R. 616, 623 (H.L.)). See generally M. HORWITZ, *THE TRANSFOR-*

lief is certainly subject to intuitive challenge and empirical contradiction.

Even if one believes, as I do, that the case for expectation damages is not self-justifying, certain instrumental arguments might be made to provide the necessary justification. For example, it could be argued that expectation damages are necessary to ensure higher moral standards or to provide society with economic benefits that would otherwise be lost. In the next section, I consider some moral and economic arguments for making protection of expectation the theoretical goal of contract remedies. I will take up questions of implementation of this theoretical goal in section IV.

II. Fuller and Perdue Revisited: Examining Arguments for the Expectation Measure

Fuller and Perdue about a half-century ago examined and rejected several suggested justifications for protecting the expectation interest of the victim of a breach of contract. The authors concluded that the strongest reason for employing the expectation measure of damages is that, as a practical matter, it is the best way to protect the promisee's reliance interest.³⁷ In other words, protection of the expectation interest is not justifiable as the goal of contract damages, but rather as the best means of reaching the goal of protecting and promoting reliance on contracts. Recently, however, scholars have offered new moral and economic arguments in support of the expectation measure. This section examines the case made in these arguments for expectation protection as the goal of contract damages rather than merely as a means to protect against reliance loss.

A. Expectation and Morality

In *Contract as Promise*, Professor Charles Fried argues that the law should use full performance as the measure of damages because full performance is what the promisor promised.³⁸ According to Fried, when an individual imposes an obligation on herself, the law generally should enforce that obligation according to its terms. A person who makes a promise has a moral obligation to keep that promise; if she does not, it is "fair" that she be made to provide either the promised performance or its

MATION OF AMERICAN LAW 186-211 (1977); Cohen, *The Relationship of Contractual Remedies to Political and Social Status: A Preliminary Inquiry*, 32 U. TORONTO L.J. 31 (1982); Hale, *Bargaining, Duress, and Economic Liberty*, 43 COLUM. L. REV. 603 (1943); Mensch, *Freedom of Contract as Ideology*, 33 STAN. L. REV. 753 (1981).

37. Fuller & Perdue, *supra* note 1, at 61-62.

38. C. FRIED, *supra* note 32, at 19.

monetary equivalent.³⁹ This conclusion is based on Fried's belief that the binding nature of a contract is rooted in the promise, not in the reliance. The argument holds that if reliance is less than expectation, use of the reliance measure excuses the promisor from her own voluntarily created obligation to the extent of the deficiency. In Fried's view, the aim of the law should be to hold people to their obligations because doing so is a way of "taking seriously their capacity to determine their own values."⁴⁰ To let the promisor escape from fully meeting her obligation would mean that we do not take her seriously as a person—we "infantilize" her.⁴¹

Although Fried's argument seems to accord with a basic sense of justice, especially when considered in the abstract, ultimately it fails to establish a satisfactory moral basis for a general choice of expectation damages. First of all, the question to be answered is not simply what is the moral obligation of an individual who has made a promise. The question is, rather, what should organized society require promisors to do when they do not keep their promises. There is an important difference between what we should hope people would aspire to and what we should force them to do.⁴² In addition, if the law of contract were to give full effect to the moral argument that people should keep their promises, the appropriate remedy would seem to be specific performance. If the law not only permits but sometimes prefers the defaulting party to pay money damages in lieu of performance,⁴³ the moral argument becomes much less compelling. The morality of promise-keeping seems more relevant to the choice between specific and substitutional relief than it does

39. *Id.* at 17.

40. *Id.* at 20.

41. *Id.* at 21.

42. Lon Fuller refers to this conflict as the "morality of duty" and the "morality of aspiration." L. FULLER, *THE MORALITY OF LAW* 5 *passim* (rev. ed. 1969). See generally H.L.A. HART, *THE CONCEPT OF LAW* 181-207 (1961). In a famous exchange of views, Fuller and Hart debated the law and morality conflict. Hart wrote a defense of the positivist approach which holds that there is always a distinction between "what is" and "what ought to be." See Hart, *Positivism and the Separation of Law and Morals*, 71 HARV. L. REV. 593 (1958). Fuller, however, disagreed that there is ever a complete break between law and morality. He argued that "coherence and goodness have more affinity than coherence and evil." Fuller, *Positivism and Fidelity to Law—A Reply to Professor Hart*, 71 HARV. L. REV. 630, 636 (1958). This affinity is what creates the internal "morality of order" which makes all law possible. So while Fuller would recognize the conflict between the "morality of duty" and the "morality of aspiration," he would not go to the positivist extreme of recognizing an amoral "what is" and a moralistic "what ought to be." In any event, both schools recognize that there are limits on how far law can go to implement the "morality of aspiration" or the world of "what ought to be."

43. See RESTATEMENT (SECOND) OF CONTRACTS ch. 16, introductory note (1981); R. POSNER, *ECONOMIC ANALYSIS OF LAW* § 4.8, at 106-07 (3d ed. 1986).

to the choice among various damage measures.⁴⁴ Once the law determines that payment of money for broken promises will suffice, it is hard to accept the claim that moral considerations dictate the amount of money that must be paid.

Before reaching any conclusions about what remedy for breach of promise is dictated by morality we might ask why the making of a promise gives rise to a moral obligation in the first place.⁴⁵ If the answer is that promisors have a moral obligation to keep their promises because other people are often hurt by broken promises, then the moral obligation might extend only to the prevention or correction of that hurt. Fried, however, argues that the ultimate basis for the moral obligation of promise is not prevention of harm to others but respect for individual autonomy and trust.⁴⁶

As Professor Macneil has pointed out, it is not certain *a priori* that enforcing people's promises against their will increases the sum total of personal autonomy.⁴⁷ It seems even less obvious that enforcing promises by means of the expectation measure will necessarily yield a net gain in personal freedom. Perhaps more importantly, it is not clear why personal autonomy should be the single, or even the primary, moral criterion. Fried argues that when the promisor seeks to be excused from some or all of her promised performance, not only does the promisee have no moral duty to accede to the promisor's request for relief but to do so would violate the requirement of morality to take other people seriously.⁴⁸ Empathy, concern for others, and generosity of spirit appear to have a subordinate place in Fried's analysis. My point is not that people should always be willing to excuse others from their obligations but rather that the moral question may be a complicated one involving conflicting moral principles. The analysis of the morality of the parties' conduct may depend to an important extent on the promisor's reasons for seeking to escape full performance of her promise. In any event, I find it hard to fault the conduct of a promisee who demands that the promisor bear the responsibility of her undertaking by paying for the harm done, but upon receiving full compensation for his loss excuses full performance or its monetary equivalent. Rather than treating the prom-

44. See Farnsworth, *Legal Remedies for Breach of Contract*, 70 COLUM. L. REV. 1145, 1149-50 (1970) (specific relief is better suited to putting the promisee in the position he would have been in had the promise been performed).

45. See *supra* note 32.

46. C. FRIED, *supra* note 32, at 16.

47. Macneil, *Values in Contract: Internal and External*, 78 NW. U.L. REV. 340, 358 (1983).

48. C. FRIED, *supra* note 32, at 20-21.

isor as an infant, the promisee may be treating the promisor as he himself would want to be treated if the tables were turned.

The rhetoric of promise-keeping and personal autonomy comes easily to those who seek to enforce the promises of others. Those with the power to negotiate favorable contracts naturally support rules that enforce those contracts to the fullest extent. But the importance of promise-keeping is not the only moral value involved in choosing a contract damages measure. One could argue in moral terms that a person should not insist on obtaining the full advantage resulting from another person's miscalculation of current market conditions, for example. Promisees seeking to enlist state power to effectuate promised advantages cannot persuasively rest their claims on any natural or necessary affinity between the expectation measure of contract damages and shared notions of morality.

B. Expectation and Efficiency

(1) *Focusing on the Breach-or-Perform Decision*

In the last twenty years several scholars interested in the economic analysis of law have turned their attention to the subject of remedies for breach of contract.⁴⁹ An early notion was that the remedy for breach of contract should be chosen with an eye toward its effect on the decisions of contracting parties about whether to perform or to breach.⁵⁰ Parties should be encouraged to perform when breach would be inefficient, and encouraged to default when breach would be efficient. Breach is efficient when the defaulting party can pay the other party enough money to make that other party indifferent to the breach, and the defaulting party is still better off than if she had performed the contract and paid no damages. The expectation measure of damages was thought to provide the precise incentive needed to make the "efficient breach" idea work.⁵¹ If

49. See, e.g., R. POSNER, *supra* note 43; Barton, *The Economic Basis of Damages for Breach of Contract*, 1 J. LEGAL STUD. 277 (1972); Birmingham, *Breach of Contract, Damage Measures, and Economic Efficiency*, 24 RUTGERS L. REV. 273 (1970) [hereinafter Birmingham, *Breach of Contract*]; Birmingham, *Damage Measures and Economic Rationality: The Geometry of Contract Law*, 1969 DUKE L.J. 49; Cooter & Eisenberg, *supra* note 7; Farber, *Contract Law and Modern Economic Theory*, 78 NW. U.L. REV. 303 (1983) [hereinafter Farber, *Contract Law*]; Farber, *Reassessing the Economic Efficiency of Compensatory Damages for Breach of Contract*, 66 VA. L. REV. 1443 (1980) [hereinafter Farber, *Economic Efficiency*]; Goetz & Scott, *supra* note 10; Shavell, *Damage Measures for Breach of Contract*, 11 BELL. J. ECON. 466 (1980).

50. See, e.g., R. POSNER, *supra* note 43, § 4.8, at 106-09; Birmingham, *Breach of Contract*, *supra* note 49, at 289.

51. See R. POSNER, *supra* note 43, § 4.8, at 107; Birmingham, *Breach of Contract*, *supra* note 49, at 285, 292.

the defaulting party pays expectation damages, she is, by definition, putting the other party in the same position as performance would have done, thus making that party indifferent to breach or performance. Damages higher than expectation damages, or specific performance, would deter efficient breaches; damages below the expectation level would fail to deter inefficient breaches.

a. Pareto Efficiency and Kaldor-Hicks Efficiency

One concept of efficiency used in this "efficient breach" argument is called "Pareto efficiency" by economists.⁵² A. Mitchell Polinsky defines "Pareto efficiency" as follows: "A situation is said to be Pareto efficient or Pareto optimal if there is no change from that situation that can make someone better off without making someone else worse off."⁵³ As a theoretical matter, the Pareto-efficiency argument for expectation damages seems airtight. The very definition of the expectation interest seems to be simply an expression of the Pareto principle. The expectation measure is defined as the equivalent of performance—as the amount of money necessary to prevent the promisee from being made worse off by breach. Payment of any lesser amount will leave the promisee worse off than if he had received performance, and thus the breach and the accompanying lesser payment cannot be a step toward Pareto optimality.

Even most proponents of the Pareto-efficiency idea would agree, however, that Pareto efficiency is not an appropriate criterion for all human behavior.⁵⁴ Requiring that every action satisfy the Pareto criterion would preclude a large portion of all human activity. Courts, for example, could never award damages at all if they took only Pareto-efficient steps, because any damage award makes the defendant worse off than if the court had not made the award.⁵⁵ Most commentators who have used the concept of Pareto efficiency seem to have advanced a smaller, and what seems to be a much less controversial, argument: if all

52. See V. PARETO, *MANUAL OF POLITICAL ECONOMY* 261 (A. Schvier trans. 1971).

53. A.M. POLINSKY, *AN INTRODUCTION TO LAW AND ECONOMICS* 7 n.4 (1983).

54. "In practical situations, it is rarely the case that the social choice is between an alternative x and an alternative y such that everyone likes x at least as well as y. The Pareto criterion can rarely be used." A. FELDMAN, *WELFARE ECONOMICS AND SOCIAL CHOICE THEORY* 142 (1980). Since the Pareto test concentrates on the best one can do within the limits of mutual benefit, it cannot consider the gains to society where one person gains more than another party loses. M. DOBB, *WELFARE ECONOMICS AND THE ECONOMICS OF SOCIALISM* 11 (1970).

55. The argument by those advocating the expectation measure of damages is not that awarding expectation damages is a Pareto-efficient step, but rather that awarding expectation damages after breach will create incentives for this defendant and others contemplating breach on future occasions to make Pareto-efficient decisions.

can agree that an action will hurt no one and benefit someone, why not take that action, regardless of what your moral philosophy might be?⁵⁶

In the context of damages for breach of contract, this more limited Pareto-efficiency argument cuts against specific performance or damages higher than the expectation amount, because these remedies discourage Pareto-efficient breach. Breach and payment of expectation damages is Pareto efficient if the defaulting party is still better off after paying expectation damages than she would have been had she performed.

The Pareto argument against damages less than expectation is not as clear. It says that breach would not be a step toward Pareto optimality, but it does not necessarily compel the conclusion that breach should not occur.⁵⁷ Breach and payment of less-than-expectation damages would generally result in both benefit to the promisor and harm to the promisee. The Pareto-efficiency argument, however, does not help us to measure which is greater or even allow us to compare the two.

To compare one person's loss with another person's gain, economists can employ the concept of Kaldor-Hicks efficiency.⁵⁸ Jules Coleman defines this concept as follows: "A redistribution of resources is Kaldor-Hicks efficient if and only if under the redistribution the winners win enough so that they could compensate the losers. The notion of Kaldor-Hicks efficiency does not require that the winners actually compensate the losers."⁵⁹ The Kaldor-Hicks argument works in theory

56. See, e.g., A.M. POLINSKY, *supra* note 53, at 7-8; R. POSNER, *supra* note 43, § 1.2, at 12, § 4.8, at 107; Birmingham, *Breach of Contract*, *supra* note 49, at 278-80 & n.20.

57. Breach and payment of less-than-expectation damages can never be a Pareto-efficient step because by definition the promisee will be worse off than if the promisor had performed. But a decision by the promisor to perform because expectation damages would exceed the promisor's gain through breach is not Pareto efficient either, because the promisor will be worse off than she was before performing. In other words, when the promisee's loss from breach exceeds the promisor's gain from breach, either the promisor or the promisee will be worse off after the breach-or-perform decision is made.

58. See, e.g., Kaldor, *A Note on Tariffs and the Terms of Trade*, 7 *ECONOMICA* 377 (1940); Kaldor, *Welfare Propositions of Economics and Inter-Personal Comparisons of Utility*, 49 *ECON. J.* 549 (1939).

59. Coleman, *Efficiency, Exchange, and Auction: Philosophic Aspects of the Economic Approach to Law*, 68 *CALIF. L. REV.* 221, 239 (1980).

The Kaldor-Hicks concept was an answer to an obvious shortcoming of Pareto efficiency, which is that "the set of alternative states likely to occur in the real world for which in fact 'everyone' in the one state will be better off than he is in an alternative or existing state cannot be very large." Mishan, *Welfare Criteria: Resolution of a Paradox*, 83 *ECON. J.* 747, 766 (1973). Kaldor-Hicks analysis shifts the focus of the welfare criterion away from the individual and onto the community. Since in a Kaldor-Hicks-efficient move, the gains in welfare will exceed the losses, there is the possibility that the winners could compensate the losers, and everyone would be better off after the move, thereby achieving Pareto efficiency. Under the Kaldor-Hicks criterion, however, there is no requirement that compensation actually take place. See A. FELDMAN, *supra* note 54, at 143-44. Although a Kaldor-Hicks reallocation of

against a damage measure less than the expectation level as well as against one higher than expectation. Like the Pareto argument, the Kaldor-Hicks argument is a simple one that starts from the premise that expectation damages equal the loss to the promisee caused by breach. If the promisor could breach and pay a lesser amount of damages, it is possible for a breach to occur that would harm the promisee more than it would benefit the promisor. On the other hand, a promisor induced by the expectation measure to perform would never incur a loss that was greater than the promisee's gain from performance; if the loss exceeded the promisee's gain, the promisor would breach and come out ahead even after paying expectation damages.

Several commentators recently have criticized these economic efficiency arguments—even the seemingly noncontroversial Pareto argument against specific performance or higher-than-expectation damages.⁶⁰ The most common criticism is that when the efficient-breach idea moves from theory to practice it loses its self-evident persuasiveness. For example, Ian Macneil criticizes the methodology of the efficient-breach theorists: "There is a fundamental intellectual flaw in using a model based on man-outside-society to analyze the behavior of man-in-society."⁶¹ He claims that the theory is indeterminate because it fails to take sufficient account of the effects of transaction costs and externalities.⁶² He argues that the conclusion that expectation damages are preferable to specific performance cannot be justified by theory alone. Although it might be argued that Macneil's criticism is a fortiori an argument against an even lesser remedy like reliance damages, his point is that the oversimplified economic analysis itself is not persuasive. His criticism would apply to the use of the analysis to support a choice of expectation over reliance as well.

There is thus a serious question about the usefulness of economic analysis based on unrealistic assumptions of perfect information, absence

resources will not necessarily be Pareto optimal or Pareto superior with regard to the original distribution, it may be either or both. Coleman, *supra*, at 240.

60. See, e.g., Linzer, *On the Amorality of Contract Remedies—Efficiency, Equity, and the Second Restatement*, 81 COLUM. L. REV. 111, 131 (1981); Macneil, *Efficient Breach of Contract: Circles in the Sky*, 68 VA. L. REV. 947, 951-52 (1982); Schwartz, *The Case for Specific Performance*, 89 YALE L.J. 271, 278-96 (1979). But see Muris, *Cost of Completion or Diminution in Market Value: The Relevance of Subjective Value*, 12 J. LEGAL STUD. 379, 381 (1983); Yorio, *In Defense of Money Damages for Breach of Contract*, 82 COLUM. L. REV. 1365, 1377-86 (1982).

61. Macneil, *supra* note 60, at 961 (footnote omitted).

62. *Id.* at 950-60. Coleman defines externalities as "inefficient external effects—social costs or benefits that result in inefficient production or nonoptimal distributions of welfare." Coleman, *supra* note 59, at 232 (footnote omitted).

of transaction costs, and neutral effects on third parties. But even if the economic efficiency arguments can tell us something useful about cause and effect, it is important to recognize that the conclusions of these economic-efficiency theorists depend upon the point of departure. Theorists making the efficient-breach arguments have assumed that the starting point from which to judge whether or not someone is made worse off is the performance level promised but not yet secured. From this starting point both the economic arguments and appeals to fairness work through to an almost inevitable choice of expectation damages. The economic arguments do not help us to make the choice of starting points; by defining anything less than full performance as "loss," these arguments have assumed away our most difficult, and fundamental, question.

If the focus is shifted from the time of contemplation of breach to the time of contemplation of contract formation, then "loss" occurs if the promisee is worse off than he was at that earlier time. One may enter into a contract and then break it as long as no one else (specifically the other contracting party) is made worse off by those actions. If the starting point is the status of the promisee before the promise was made, then by definition the reliance measure is the one suggested by the notion of economic efficiency.

In sum, the fact that economic efficiency analysis leads to different conclusions depending upon the starting point of the analysis provides one illustration of the general point that it is not appropriate to judge remedies for breach of contract solely on the basis of their effect on the breach-or-perform decision.

b. Sales to Lower-Value Users

Before turning to other factors influencing the choice of remedies for breach of contract, let us examine another economic argument for expectation damages that focuses exclusively on the breach-or-perform decision—the argument that any remedy less than full expectation damages may result in breaches by sales to lower-value users.⁶³ Such breaches would be inefficient, according to this argument, because if the subject of a contract ends up in the hands of someone who values the item less than does the original buyer under the contract, society is worse off than if the contract had been performed and the item delivered to the original buyer.

A. Mitchell Polinsky gives the following hypothetical example to illustrate the point:

63. See A.M. POLINSKY, *supra* note 53, at 29-32.

S is the seller of a widget with production costs of \$150

B1 is a buyer who values the widget at \$200

B1 incurs reliance expenditures of \$10

B1 pays *S* the contract price of \$160 in advance

B2 is a buyer who values the widget at \$180⁶⁴

Polinsky argues that under these facts (and other necessary assumptions)⁶⁵ an inefficient breach may result under a reliance measure of damages.⁶⁶ *S* can breach, pay reliance damages to *B1* of \$170 (\$160 paid in advance plus \$10 reliance expenditure), and sell to *B2*, who would pay up to \$180 for the widget. Since *B2* values the widget at \$180 and *B1* at \$200, the widget will wind up in the hands of a lower-value user.⁶⁷

A sale to a lower-value user is inefficient because under economic theory the value a person places on an item determines the benefit that accrues to him when he receives it. If *B1* values the widget at \$200 and if *B2* values the widget at \$180, it is in the interests of both *B1* and *B2* that *B1* wind up with the widget. A sale of the widget from *B2* to *B1* for \$180 makes *B1* better off without making *B2* any worse off. A sale of the widget from *B2* to *B1* for \$200 makes *B2* better off without making *B1* any worse off. Thus a sale from *B2* to *B1* (that is, from the lower-value to the higher-value user) at any price between \$180 and \$200 is a Pareto-efficient step.

How often is an inefficient result likely to occur under the reliance measure? The sale to *B2* will not take place unless *B2* offers to pay more money to *S* than *S* received under the contract with *B1*. The sale to *B2* will not be inefficient unless *B2* places a lower value on the widget than does *B1*. So *B2* must make a higher offer than *B1* did on an item that he values less than *B1* does. This is the starting point, and already it seems that the cases that present the problem would be exceptional ones.⁶⁸

64. *Id.* at 26-32.

65. Polinsky's assumptions include the following: The parties are risk-neutral. *Id.* at 27. There is no replacement market for widgets. *Id.* at 26. There is no bidding for widgets by *B1* and *B2*, and no renegotiation of contract terms by *B1* and *S*. *Id.* at 29.

66. *Id.* at 32.

67. *Id.*

68. When *B1*'s reliance expenditures are added to the return of the contract price already paid (that is, when reliance expenditure damages are added to the bare restitution measure) the possibilities of a sale to a lower-value user are further reduced. Again, the breach by sale to *B2* is inefficient only if *B1*'s value (*B1V*) is greater than *B2*'s value (*B2V*). The breach will not occur under a reliance expenditure measure of damages unless *B2V* is greater than the sum of the original price (*B1K*) and *B1*'s reliance expenditures (*B1RE*). The conditions for inefficient breach under a reliance expenditure measure would be: $B1V > B2V$ and $B2V < B1K + B1RE$.

In words, the range of possible offers by *B2* that would result in an inefficient breach falls between *B1*'s value at the upper end and the combination of *B1*'s contract price and *B1*'s reliance expenditures at the lower end. This range will be nonexistent unless the gap between

If *B1* contracted to pay so much less for the widget than it is worth to him (so that even if he receives a full return of the contract price and full compensation for reliance expenditures and lost opportunity he will still be worse off than if the contract had been performed), you might expect *B1* to renegotiate with *S* and offer to pay more for the widget to prevent *S* from selling to *B2*. *B1* should win any bidding war with *B2* because *B1* places a higher value on the widget than does *B2*. We thus come to one of the assumptions necessary to reach the conclusion that the reliance measure will lead to widgets winding up in the hands of lower-value users. Polinsky assumes that renegotiation by *B1* with *S* or repurchase by *B1* from *B2* will not be worthwhile because of bargaining costs, noting in this connection that absent bargaining costs the Coase Theorem tells us that any remedy would be equally efficient.⁶⁹

Another important assumption necessary to Polinsky's lower-value user illustration is that there is no readily available market in which to purchase replacement widgets.⁷⁰ As indicated in section I of this article,⁷¹ in a perfectly competitive market, the lost-opportunity reliance measure of damages will be the same as the expectation measure. Neither measure will lead to breaches by sales to lower-value users.

If we depart from the fictional world of perfect competition and if we assume that widgets are generally available in markets in the less-than-perfect real world, even the expectation measure of damages may not prevent all sales to lower-value users. In Polinsky's example, the expectation recovery had to equal the full value that *B1* placed on the widget (\$200). Since *B1* could not obtain a widget elsewhere, only the full \$200 would place him in the same position that he would have been in had *S* performed the contract as promised. But assume that there is a

the value that *B1* places on the widget and the contract price that *B1* negotiated with *S* exceeds *B1*'s reliance expenditures.

What happens when we add lost opportunity to the concept of reliance? Polinsky assumes that if *B1* had not entered into the contract for the widget with *S*, *B1* would have earned zero profit (in other words *B1* did not forgo any opportunities to contract with *S*). He then asserts in a footnote: "This assumption is not essential and does not affect any of the general conclusions about the reliance remedy." *Id.* at 30 n.20. Polinsky may be right in the sense that the addition of the concept of lost opportunity does not disturb his general conclusion that the reliance measure theoretically can result in sales to lower-value users. But to the extent that lost opportunities are included in the calculation of reliance damages, the chances for sales to lower-value users under a reliance measure are reduced even further.

69. *Id.* at 29. The Coase Theorem was introduced in Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960). For an explanation of the Coase Theorem, see A.M. POLINSKY, *supra* note 53, at 11-14.

70. A.M. POLINSKY, *supra* note 53, at 26.

71. See *supra* text accompanying notes 17-18; see also Cooter & Eisenberg, *supra* note 7, at 1444-59; Eisenberg, *supra* note 6, at 746-47; Goetz & Scott, *supra* note 10, at 1284.

market for widgets. Further assume that the market price of widgets at the time of *S*'s breach was \$160, that *B2* subjectively values the widget at \$180, and that *B2* offers to buy from *S* at \$165. Under these assumptions, *B1*'s expectation damages will be reduced from \$200 to \$160 (plus the additional cost of making the substitute purchase) because *B1* could wind up in the same position as if *S* performed by purchasing another widget for \$160.⁷² It will be profitable for *S* to breach because *B2*'s offer of \$165 exceeds the expectation damages of \$160.

Of course, there is an apparent problem with this example: why would *B2* offer \$165 for a widget that is obtainable on the market for \$160? But if contract offers always equaled market price then expectation and lost-opportunity reliance would always be equal. Expectation damages will exceed lost-opportunity reliance damages only if the defaulting party offered a better deal to the nondefaulting party than was available from any other source. If we are willing to accept the possibility of a seller's offer deviating from the market price, then we should also accept the possibility of a buyer's offer deviating from the market price.

The observations in this subsection so far serve to minimize the importance of the argument that expectation damages are efficient because they prevent breaches by sales to lower-value users, but they do not refute that argument. I have argued that under a lost-opportunity reliance damages measure these inefficient breaches are likely to be quite rare, difficult to detect, and more theoretical than real. An advocate of the expectation measure might well respond that even if these inefficient breaches are rare, we should not tolerate them when they can be avoided by choosing the expectation measure. I have pointed out that the argument that reliance damages may result in items winding up in the hands of lower-value users depends upon the assumption that there will be no renegotiation between the contracting parties and no buy-backs by the nondefaulting party from a third party. The response to this point is that negotiations cost money, and these unnecessary transaction costs could be avoided by adherence to the expectation measure. However, as I have shown, under certain conditions breaches by sales to lower-value users are possible even under an expectation measure. One might respond to this final point by arguing that the question is not whether expectation damages will lead to any inefficient breaches, but rather whether they

72. The existence of a replacement market for widgets allows the court to protect *B1*'s expectation by awarding him the "objective" (market) value of the widgets (\$160) instead of using *B1*'s subjective value (\$200) as the measure of lost expectation. Since we assume these are fungible widgets, a replacement widget should have the same subjective value to *B1* as the widget for which he originally contracted.

will lead to fewer inefficient breaches than would occur under a reliance measure.

These arguments and counterarguments conceal the major point, which is that the strength of the economic efficiency argument for expectation damages depends upon the question that is being asked. If we assume that we find ourselves at a point in time when a contracting party is deciding whether or not to perform her contract,⁷³ and if we further assume that we want to create the optimal incentive for that party to make her decision whether or not to perform on the basis of what would be the optimal result for the two contracting parties considered together, exclusive of the effects on third parties,⁷⁴ and if we accept the general methodology of economic arguments including their implicit assumptions about how people react to economic incentives, then the expectation measure is not only the best choice of incentive, it is the definition of the optimal incentive.

But the reliance measure that gives full effect to the concept of lost opportunity is inferior to the expectation measure only if we make all these assumptions. If we change or broaden the inquiry, the expectation measure may no longer define the optimal result. The possible effects of a particular remedy other than its effects on the breach-or-perform decision must be examined before reaching any ultimate conclusion about the most efficient remedy for a breach of contract.

(2) *Other Effects Influencing the Selection of a Remedy for Breach of Contract*

Economic arguments generally assume that people will adjust their behavior in response to changes in economic incentives. For example, the economic arguments discussed so far assume that people will respond to differing measures of damages by altering their breach-or-perform decisions in the future. One possible response to these arguments is to be skeptical about the efficacy of incentive creation; one might doubt whether what judges decide in litigated cases about the proper measure

73. Ian Macneil points out that the "efficient breach" concept is based not on the decision to breach, but rather on the decision to perform. The objective is to perform the most economically efficient contract. If that decision requires the nonperformance of a less advantageous contract, there are several ways to achieve that end, breach being but one. The parties to the less advantageous contract may renegotiate, or the original supplier may secure the desired performance from some other supplier. There are options available which fall short of outright breach of the less advantageous contract. *See* Macneil, *supra* note 60, at 950-51.

74. According to Macneil, failure to consider all the costs associated with breach (*e.g.*, litigation, harm to reputation, etc.) increases the likelihood of inefficient breaches. *See id.* at 960. Since we hope to maximize efficiency at the systemic level, the traditional focus of "efficient breach" at the contracting parties' level seems misplaced.

of damages for breach of contract will have a significant effect on the behavior of future contracting parties. The skeptic might be more concerned about reaching a proper result in the case to be decided than about attempting to affect future behavior.

Another possible response to the breach-or-perform economic arguments is to argue that the choice of remedy for breach of contract may influence behavior in matters other than the decision whether to breach or perform the contract. Some of these possible effects will be discussed briefly in this section, although no attempt will be made to be complete either in the identification of behavior that might be affected or in the exploration of what the effects on that behavior might be. The general point is that any efficiency analysis that suggests a particular remedy has many effects to consider beyond the decision to breach or to perform.

a. Effect on the Level of Future Contracting Activity

An important consideration—perhaps the most important one—in choosing a remedy for breach of contract is the effect that choice will have on the readiness of people to form contracts in the future. Some who argue for the expectation measure attempt to forge a link between the breach-or-perform decision and the incentives for future contracting activity.⁷⁵ Daniel Farber sets out this argument, which he says follows from the “neoclassical model” of contract (a model that he criticizes because it is based on unrealistic assumptions of perfect information and absence of transaction costs):⁷⁶ Whenever the amount of damages for breach is less than the cost of performance, an incentive exists for a party to breach. Obviously, if people do not perform their contracts, people will no longer enter into contracts. But even if most people do perform their contracts, the existence of any breach activity remedied by damages less than the value of full performance will make the nondefaulting party unwilling to pay the same amount as he would if performance were assured. If the price goes down, the “honest” people who were performing all the time will no longer be able to afford to perform at the same level. The effect is a downward spiral of price and performance until the market collapses and no contracts are formed.⁷⁷

If this argument is correct, it is difficult to understand how the institution of contract has survived. Even with the expectation measure as

75. See, e.g., Barton, *supra* note 49, at 278-79.

76. Farber, *Contract Law*, *supra* note 49, at 310-18, 324.

77. *Id.* at 321. Farber points out that this is an illustration of the “lemons” problem. *Id.* at 321 & n.84, 326-27 & n.113 (citing Akerlof, *The Market for “Lemons”: Quality, Uncertainty and the Market Mechanism*, 84 Q.J. ECON. 488 (1970)).

the predominant standard for contract damages, we have not been able to eliminate all inefficient breaches or to guarantee that a party victimized by breach will always be as well off as if there had been full performance. Yet markets do not crumble. People still enter into contracts. Intuitively, it does not seem that a reliance measure of damages would prevent people from entering into contracts. Will not people continue to contract if they think that they may benefit from the performance of the contract and that if something goes wrong at least they will be restored to the position that they would have been in had they not contracted?

Charles Goetz and Robert Scott focus on the optimal level of promissory activity in constructing their economic argument for what amounts to the lost-opportunity reliance measure of damages.⁷⁸ They attempt to demonstrate that, if the goal of a damages remedy is to create the optimal incentive for people to make efficient decisions about whether or not to make promises, traditional economic analysis supports choosing the reliance measure.

b. Effect on the Allocation of Risk

Polinsky has argued that another effect of the choice of a remedy for breach of contract that should be considered is the impact of the remedy on the allocation of risk between the contracting parties.⁷⁹ If one party is more risk averse than the other, it is in both parties' interests for the risk averse party to pay the other party to bear the risks associated with the contract. A remedy that encourages this risk allocation is efficient to that extent.

To illustrate his argument, Polinsky uses a hypothetical sale of goods situation in which the risk to be allocated is the (beneficial) risk that another buyer will offer to purchase the subject matter of the contract for more than the agreed contract price set by the seller and the original buyer. Polinsky concludes that under these circumstances (with some additional assumptions) the expectation measure of damages is more efficient than either the reliance or the restitution measures.⁸⁰ If the buyer is risk averse and the seller is risk neutral, the expectation measure is the efficient remedy because it leaves the buyer in the same position whether or not the second buyer makes his offer. If the buyer is risk neutral and the seller is risk averse, the efficient measure is the amount of the second buyer's offer, because that measure leaves the seller in the

78. See Goetz & Scott, *supra* note 10, at 1281-86.

79. A.M. POLINSKY, *supra* note 53, at 57-63; Polinsky, *Risk Sharing Through Breach of Contract Remedies*, 12 J. LEGAL STUD. 427 (1983).

80. Polinsky, *supra* note 79, at 433-36.

same position whether or not the offer is made. If both parties are risk averse, the proper measure of damages lies somewhere between the expectation measure and the higher level of damages measured by the offer of the second buyer. According to this argument, since the expectation measure is just right if the buyer is risk averse and the seller is risk neutral, and too small if the seller is risk averse, a reliance measure that is less than the expectation measure is never efficient with respect to risk allocation.⁸¹

Although Polinsky's analysis seems sound under his assumptions and as applied to his hypotheticals, it is not a persuasive argument for a general choice of the expectation measure over the reliance measure. First, as Polinsky recognizes, when the risk to be allocated is a risk of loss rather than a risk of gain, the reliance measure may be more efficient than the expectation remedy would be, if the breaching party is risk averse and the nonbreaching party is risk neutral.⁸² For example, assume that the risk to be allocated is that the seller's production costs will be greater than expected. Further assume that those abnormal production costs will exceed the value the buyer places on the goods to be sold. Efficiency dictates breach by the seller. The optimal damages payment, to place the risk of higher production costs on the nonbreaching party, will be the seller's normal production costs, because in that event the seller is put in the same position whether the production costs are above normal or not.⁸³ The reliance measure of damages, although probably too large,⁸⁴ will be closer to optimum than would the expectation measure, which normally will be larger than the reliance measure (because if the value the buyer placed on the good to be sold did not exceed the seller's normal production costs, the buyer would not have contracted to buy).

The second reason that Polinsky's risk-allocation analysis does not necessarily support a general preference for expectation damages over reliance damages is that it may be difficult to determine who is or is not risk averse if the parties do not specify any remedy in the contract. The risk-allocation argument provides greater support for enforcing liquidated damages clauses than it does for awarding expectation damages.⁸⁵

81. *Id.* at 435-36.

82. *Id.* at 442-43.

83. *Id.*

84. Reliance damages would equal the return of the contract price plus the buyer's reliance expenditures, a figure that we can assume will exceed the seller's normal production costs, because otherwise the seller would not have contracted to sell.

85. If the parties to a contract were concerned solely with the allocation of risk, then they would choose a damage payment that allocates risk according to their relative aversion to risk.

c. Effect on the Level of Reliance Investment

Another criterion that Polinsky uses to evaluate contract remedies is their effect on the level of reliance investment by the contracting parties.⁸⁶ If we assume that reliance expenditures are totally wasted if the contract is not actually performed,⁸⁷ then we can create an incentive for the optimal level of reliance expenditure by placing the risk of nonperformance on the party making the reliance investment decision. If a contracting party is aware that he will be denied compensation for reliance expenditures if the other party fails to perform, he will appropriately calculate the chances of nonperformance and include that calculation in his decision whether or not to invest in reliance activity.⁸⁸

Polinsky concludes that under the optimal-reliance-investment criterion both the expectation and reliance measures are inefficient because they both protect contracting parties from loss due to imprudent reliance investments.⁸⁹ According to Polinsky, the expectation measure protects the reliance investor by, in effect, guaranteeing performance,⁹⁰ so that the reliance investor is guaranteed to receive the increased value of contract performance generated by his reliance investment whether or not the contract is actually performed. The reliance measure protects the reliance investor by directly reimbursing the reliance costs if the contract is not performed. Damage measures that do not increase as the level of reliance investment increases, such as the restitution measure or a no-damages rule, would be efficient under this analysis.⁹¹

d. Other Possible Effects

Polinsky's reliance-investment-decision argument and his breach-or-perform-decision argument can point in different directions.⁹² In order to choose an appropriate remedy one may have to decide which criterion is more important in the particular fact situation. Yet still other effects

Therefore, a liquidated damages remedy would, by definition, allocate the risk in the most efficient way. A.M. POLINSKY, *supra* note 53, at 62-63.

86. *Id.* at 32-35.

87. *Id.* at 32; Polinsky, *supra* note 79, at 435.

88. A.M. POLINSKY, *supra* note 53, at 33; Polinsky, *supra* note 79, at 435-36.

89. A.M. POLINSKY, *supra* note 53, at 33-35.

90. *Id.* at 33.

91. *Id.* at 34-35 & n.22. Cooter and Eisenberg argue that the problem of "overreliance" often is not important and that if recovery is limited to reasonable reliance, both expectation and reliance measures would lead to efficient levels of reliance. Cooter & Eisenberg, *supra* note 7, at 1465-68.

92. Polinsky claims that his breach-or-perform analysis supports an expectation measure and that his optimal-reliance analysis supports a restitution measure. A.M. POLINSKY, *supra* note 53, at 36.

must be considered. If we are concerned about expenditures made on the assumption that the contract will be performed (what we have been calling "reliance investment"), we should also be concerned about expenditures made to protect oneself in case the contract is not performed (what some have called "precautionary" investment).⁹³ Promoting the optimal level of precautionary investment is another criterion by which to judge a remedy for breach of contract. The same might be said about "reassurance" activity—actions taken by promisors to convince their contracting partners that they will honor their performance obligations.⁹⁴

In addition, the choice of damage remedies might have effects on the amount of resources expended to negotiate remedial terms, on litigation costs, on distribution of wealth, on the costs and benefits to third parties, on respect for the institution of contract or for the legal system, and so on.⁹⁵ When we choose to go beyond making our best assessment of the proper corrective action in the individual case in order to create incentives for future behavior, we enter a complicated and uncertain world.

(3) *Concluding Observations on Efficiency Arguments*

Existing economic arguments do not demonstrate the superiority of the expectation measure of contract damages. Even if we put aside arguments rejecting the whole idea of economic analysis either because its unrealistic assumptions make it useless or because its political and philosophical biases make it pernicious, we still must face the fact that the effects of a choice of remedy are many and complex. Current economic theory simply cannot provide conclusions about the choice of remedy in light of all the possible effects. Perhaps more importantly, even sophisticated economic analysis does not always tell us how to frame our questions. The concept of Pareto efficiency, for example, fails to address the crucial question of how we should define "loss."⁹⁶ In short, economic analysis does not provide a convincing answer to Fuller and Perdue's question: Why protect the expectation interest?

III. Choosing Between Expectation and Reliance Damages When Reliance Loss Exceeds Lost Expectation

Before considering the practical problems involved in implementing

93. See Goetz & Scott, *supra* note 10, at 1274. Cooter and Eisenberg talk about "precaution" by the promisor to avoid the promisor's own breach. Cooter & Eisenberg, *supra* note 7, at 1464.

94. See Goetz & Scott, *supra* note 10, at 1274.

95. See the list of possible effects in Cooter & Eisenberg, *supra* note 7, at 1462.

96. See *supra* subsection II.B(1)(a).

a reliance measure that takes account of lost opportunities, we should pause to examine a situation that might cast some doubt on the choice of reliance protection as the theoretical goal of a breach of contract remedy. The discussion so far has assumed that the choice is between the expectation measure of damages and a lesser reliance measure. It is possible, however, for reliance loss to exceed expectation loss. This section will consider, first, whether the expectation loss should act as an upper limit on reliance damages, and then, second, whether an affirmative answer would betray an inconsistency in the analysis.

A. Choosing Between Expectation and Reliance When Reliance is Greater

In most cases of contract formation and breach, an expectation award will be equal to or greater than a reliance award, even if the reliance measure gives full effect to the concept of lost opportunity. This observation should not be surprising, since we would expect that the victim of the breach chose to enter into the contract because he preferred what his position would be after performance to his position before contracting. Thus, before attempting to choose between expectation and a greater reliance remedy, we first should try to identify when we will be faced with this unusual choice.

Reliance loss will exceed expectation loss whenever full performance of the contract would have left the plaintiff in a worse position than he would have occupied had he not entered into the contract with the defendant in the first place. The contract need not be a "losing contract" in the sense that full performance would have made the plaintiff worse off than if he had not contracted with anybody at all.⁹⁷ Since reliance loss includes lost opportunity, reliance damages exceed expectation damages whenever full performance of the actual contract would have been less advantageous to the plaintiff than full performance of a contract the plaintiff would have entered into (if any) had he not contracted with the defendant. The plaintiff may have lost such superior opportunity either at the time of formation of the contract or at some time after formation.⁹⁸

97. When commentators use the term "losing contract," they usually mean that performance of the contract would have made the plaintiff suffer a net out-of-pocket loss. See, e.g., J. CALAMARI & J. PERILLO, *THE LAW OF CONTRACTS* 533 (2d ed. 1977); D. DOBBS, *HANDBOOK ON THE LAW OF REMEDIES* 867-77 (1973); Fuller & Perdue, *supra* note 1, at 77-79.

98. Richard Bronaugh has set forth a series of situations in which lost opportunity exceeds lost expectation to illustrate his argument that lost opportunity should not be a compensable item of contract damages. See Bronaugh, *Lost Opportunities in Contract Damages*, 17 VAL. U.L. REV. 735 (1983). Since Bronaugh assumes throughout his article that at least expectation damages will be awarded, he does not address the choice between the expectation measure and a lesser lost-opportunity reliance measure. Thus, his analysis is directly relevant only to section III of this Article.

(1) *Opportunities Lost at the Time of Formation*

Under what circumstances would the plaintiff forgo an opportunity that was better for him than the contract he entered into? One possibility is that he was unaware of the better opportunity. If that is the situation, the case for a damages recovery based on loss of that opportunity seems quite weak. If the plaintiff was not aware of the opportunity when he contracted with the defendant, it is hard to see how the loss of that opportunity can be attributed to the defendant's offer.⁹⁹ The plaintiff would not have had the benefit of this opportunity even if there had been no contract with the defendant, unless contracting with the defendant prevented the plaintiff from discovering that opportunity.

A more compelling example of a forgone superior opportunity is when the plaintiff knowingly chooses the defendant's offer even though its terms are not as favorable as those of another offer because of the belief (mistaken as it turns out) that the defendant is more reliable and more likely to keep her promise. Assume the following facts: *A* is considering an offer from Company *X* to sell to *A* a quantity of heating oil with delivery to begin in six weeks. A saleswoman for Company *Y* comes along and tells *A* that Company *X* is a relatively new and untested company, but that Company *Y* has a long history and a good name (assume that the quality of the heating oil is the same). She looks at *X*'s offer and asks *A* if he is willing to pay a little more for the assurance that delivery will be made as promised. *A* contracts with *Y* at a higher price than *X*'s offer because of the concerns raised by *Y*'s saleswoman. When delivery time arrives, *Y* fails to deliver to *A* as promised, and *X* meets all its delivery commitments. The market price for heating oil at the time *A* learns of the breach exceeds both the contract price with *Y* and the price that had been offered by *X*.

The expectation measure of damages in this situation would be the difference between the contract price and the market price.¹⁰⁰ If a judge were to find as a matter of fact that if *A* had not contracted with *Y* he would have contracted with *X*, should he or she measure *A*'s damages by the difference between the price that *X* offered and the market price? Fuller and Perdue would not think so, because awarding full reliance damages to *A* would put him in a better position than he would have

99. See *id.* at 739-40. If the plaintiff was truly unaware of the opportunity and never would have discovered it even if he had not contracted with the defendant, then it seems to be stretching the words to say that he has "forgone" an opportunity, or even that he has "lost" an opportunity.

100. See U.C.C. § 2-713 (1978). For an excellent discussion of the relationship of standard damage formulas to expectation theory, see Cooter & Eisenberg, *supra* note 7, at 1438-44.

occupied had the contract with *Y* been fully performed.¹⁰¹ This result would be wrong, they would say, because permitting a recovery in excess of the expectation measure would allow *A* to shift to *Y* the loss attributable to *A*'s choice of *Y* over *X*,¹⁰² a move that is unjustifiable since *A* freely chose to contract with *Y*. Although Fuller and Perdue's argument is a strong one that has received general acceptance,¹⁰³ the circumstances of this particular hypothetical create an attractive case, in my view, for requiring *Y* to make *A* as well off as he would have been had *Y*'s saleswoman never approached him. Some may remain unconvinced that an award in excess of expectation is justified even when the promisor directly induces the promisee to forgo a more favorable opportunity. But if the greater reliance award is considered appropriate here, which facts are necessary to that conclusion? What if it was not *Y*'s saleswoman who convinced *A* to accept the more expensive offer? What if *Y*'s saleswoman made no explicit mention of her company's reliability for timely delivery? What if *Y*'s saleswoman was not aware of the terms of *X*'s offer? These questions may be difficult to answer, but the point is that it is not always an obvious truth that an expectation award is more appropriate than a greater reliance award calculated on the basis of an opportunity that the plaintiff knowingly gave up in entering into a contract with the defendant.

One reason that the heating oil hypothetical presents a somewhat appealing case for the lost-opportunity reliance measure is that the defendant convinced the plaintiff to make a choice that (except for the perceived reliability factor) was less advantageous for the plaintiff at the time the choice was made. The attractiveness of the lost-opportunity measure is reduced if we view the situation as simply involving a bad

101. Fuller & Perdue, *supra* note 1, at 79 ("We will not in a suit for reimbursement for losses incurred in reliance on a contract knowingly put the plaintiff in a better position than he would have occupied had the contract been fully performed.") (emphasis in original); see also *Manganaro Bros. v. Gevyn Constr. Corp.*, 610 F.2d 23 (1st Cir. 1979) (construction contract); *United States v. Mountain States Constr. Co.*, 588 F.2d 259 (9th Cir. 1978) (construction contract); *L. Albert & Son v. Armstrong Rubber Co.*, 178 F.2d 182 (2d Cir. 1949) (manufacturing contract); *Kizas v. Webster*, 532 F. Supp. 1331 (D.D.C. 1982) (employment contract), *rev'd on other grounds*, 707 F.2d 24 (D.C. Cir. 1983); *Dialist Co. v. Pulford*, 42 Md. App. 173, 399 A.2d 1374 (1979) (franchise agreement).

Bronaugh argues that requiring the defendant to pay reliance damages in excess of expectancy would force him to "pay more than the value of his promise." Bronaugh, *supra* note 98, at 741. It is not clear exactly what Bronaugh means by this statement. Would he also argue against awarding reasonably foreseeable consequential damages exceeding the value of the defendant's performance? Would these damages be more acceptable if we called them tort damages? See generally Birmingham, *Notes on the Reliance Interest*, 60 WASH. L. REV. 217 (1985).

102. Fuller & Perdue, *supra* note 1, at 78.

103. See, e.g., D. DOBBS, *supra* note 97, at 877.

guess about future circumstances. To illustrate, assume that *P* sporting goods company is looking for a tennis player to endorse its newly developed tennis racket. *P* speaks with agents for *D* and *Q*, two rising stars in the professional tennis cosmos. After extensive market research, *P* determines that the selling power of the two players, at the present time, is about equal. Player *D* offers her endorsement for \$25,000; Player *Q* wants \$30,000. *P* thus contracts with *D*. *D* has a successful season, and the value of her endorsement goes up to \$40,000. *Q* has an equally successful season, but also stars in a popular new movie. The value of her endorsement skyrockets to \$100,000. *D* breaks her agreement with *P* by endorsing the racket of another company for \$40,000. The traditional expectation measure would result in a judgment for *P* against *D* in the amount of \$15,000 (contract price/market price difference). The lost-opportunity reliance measure would yield a judgment of \$70,000 (forgone price/market price difference).¹⁰⁴

In this situation, the \$15,000 expectation award seems to be the more appropriate choice. By choosing to deal with *D*, *P* in a sense tied its interests with hers; a deal was formed under which *P* shared in *D*'s success or failure on the tennis courts. Since *D* was not responsible for the change in circumstances that made the value to *P* of a contract with *Q* exceed that of a contract with *D*, even *D*'s willful breach does not seem to justify imposing the burden of this change on her.

(2) *Opportunities Lost Subsequent to Contract Formation*

Sometimes opportunities may be lost after the contract with the defendant has been formed but before breach occurs. Consider the following illustration: *P* contracts with *D* to buy 1000 pints of strawberries for a total price of \$1000, payable on delivery in eight weeks. One week later *Z* offers to sell to *P* 1000 pints of strawberries of equal quality for \$800, payable on the same delivery date as set forth in *P*'s contract with *D*. *P* needs only 1000 pints. *P* calls *D* and asks if *D* still intends to deliver the strawberries as promised. *D* responds that she will definitely do so. *P* informs *D* of *Z*'s offer, and asks *D* if she would reduce the price to \$800 or let *P* out of the contract. *D* refuses both requests. The market price for strawberries then rises rapidly and on the delivery date is \$1200. *D* sells the strawberries promised to *P* to someone else for \$1200. *P* sues *D* for breach. Should damages be assessed in the expectation amount of \$200 or in the lost-opportunity reliance amount of \$400?

104. This problem might raise questions of foreseeability. It could be argued here that the larger reliance award was not reasonably foreseeable by the defendant. See *infra* note 116.

Proponents of the expectation measure would argue that a \$200 damages award should be sufficient to discourage *D* from breach. They would ask for a justification for placing *P* in a better position than he would have occupied had *D* performed. They would point out that for *P* to have taken advantage of the opportunity offered by *Z*, *P* himself would have had to break his contract with *D*.¹⁰⁵ Nevertheless, when one party's fidelity to a contract causes him to forgo an opportunity that would have placed him in a better position than the one the defendant left him in, there seems to be some justice in requiring the defendant to make up that difference.

Like the heating oil hypothetical illustrating lost opportunity at the time of contract formation,¹⁰⁶ this hypothetical creates some sympathy for the lost-opportunity measure of damages. These hypotheticals suggest that sometimes plausible arguments can be made for the reliance measure even when the effect would be to place the plaintiff in a better position than that which performance would have placed him in. If these arguments are found to be persuasive, expectation cannot be viewed as the absolute limit of reliance damages.¹⁰⁷

105. Bronaugh, *supra* note 98, at 741. In Bronaugh's words, the plaintiff in this situation is not losing an opportunity, but rather "eschew[ing] opportunism." *Id.*

106. See *supra* text accompanying notes 99-103.

107. In a recent article, Henry Mather argues against awarding restitution damages in excess of expectation damages in cases of partial performance by a seller followed by the buyer's breach. Mather, *Restitution as a Remedy for Breach of Contract: The Case of the Partially Performing Seller*, 92 YALE L.J. 14 (1982). Although Mather's discussion concerns the choice between expectation damages and a higher amount of restitution damages, much of it is relevant to the choice between expectation damages and a higher amount of reliance damages.

Mather begins by arguing that economic analysis is not helpful in making the choice between restitution and expectation because transaction costs, particularly uncompensated costs of litigation and other breach-related costs, render that analysis indeterminate. *Id.* at 21-28. Mather turns to what he calls "liberal principles" for guidance. He identifies three "principles" that he finds helpful: Minimal Coercion, Causal Responsibility, and Consent. *Id.* at 29-34. Applying these principles to the choice between restitution and expectation recoveries for the partially performing seller (who, by assumption, cannot be given back his partial performance in specie), Mather concludes that expectation is the proper choice. *Id.* at 36. Since the buyer did not consent to pay anything in particular for partial performance, an interference with buyer's liberty is required to protect the nondefaulting seller's higher-priority liberty. That interference should be minimal—just enough to compensate the seller for losses caused by the buyer's breach. The restitution measure would put the seller in a better position than if there had been no breach, and thus would exceed damages caused by the breach. This argument would seem to apply with equal force to all reliance recoveries in excess of expectation; thus Mather presumably would object to any reliance recovery that exceeds the expectation level of damages.

Mather's argument for limiting recovery to the expectation measure is not convincing. First of all, after he concludes that the undercompensation problem is so serious that it makes

B. The Choice When Reliance Exceeds Expectation: A Different Rule for a Special Case?

The previous subsection presented a couple of appealing cases for choosing a lost-opportunity reliance measure over a smaller expectation measure. Even in these situations, however, there are strong counter-arguments for limiting damages to the expectation level. Admittedly, in many if not most cases in which reliance exceeds expectation, the lesser expectation amount seems preferable. The question then arises whether it is consistent to argue that the goal of contract remedies should be to protect against loss rather than to ensure expectation, and yet to use the expectation measure as a ceiling on recovery.

One attempt to avoid the charge of inconsistency might be to argue that "true" reliance damages for breach cannot exceed expectation damages. The argument would be that a damage award above the expectation amount cannot be justified as compensation for loss resulting from the defendant's breach. The expectation theory says that if there had been no breach, the plaintiff would have been in, say, position *X*. Awarding damages that would put the plaintiff in a better position than *X*, therefore, by definition cannot be compensation for loss caused by breach.

Of course, as indicated in section I,¹⁰⁸ this position is an argument against reliance recovery in general, not just reliance recoveries in excess of the expectation amount. Although some reliance losses are attributa-

all economic analysis inconclusive and unhelpful, he fails to mention that problem again in his discussion of "liberal principles."

Mather's applications of his principle of Consent raise doubts about whether he is actually talking about consent as a matter of fact. He apparently assumes that in all cases: 1) the buyer does not consent to pay the contract rate or any other particular price for partial performance even when the reason for the seller's incomplete performance is the buyer's breach, *id.* at 34; 2) the buyer does consent to return any partial performance that can be returned in specie upon the buyer's breach, *id.* at 37; and 3) the seller agrees to return all money paid by the buyer under the contract upon the seller's breach, *id.* at 36-37. The cumulative effect of these seemingly conclusive presumptions about consent is that both a plaintiff-buyer and a plaintiff-seller whose part performance can be returned in specie can always choose either restitution or expectation, whichever is greater. The plaintiff-seller whose part performance cannot be returned in specie, however, is limited to an expectation recovery. These differing resolutions of situations involving breach after part performance seem questionable as a matter of public policy, and it strains credulity to justify them on the grounds that they simply reflect what contracting parties invariably intend as a matter of fact.

For other criticisms of Mather's article, see Gegan, *In Defense of Restitution: A Comment on Mather*, Restitution as a Remedy for Breach of Contract: The Case of the Partially Performing Seller, 57 S. CAL. L. REV. 723 (1984).

For an earlier treatment of restitution claims in excess of expectation loss, see Palmer, *The Contract Price as a Limit on Restitution for Defendant's Breach*, 20 OHIO ST. L.J. 264 (1959).

108. See *supra* text accompanying notes 12-16.

ble to the breach of a contract and not simply to its existence, most reliance losses would have occurred even if the contract had been performed, and in that sense were not caused by the breach.¹⁰⁹ It thus seems that one must decide whether the fact that reliance losses would have occurred even without a breach is a compelling argument against awarding reliance damages for breach of contract. If the answer is yes, then reliance loss compensation should not be the goal of contract remedies whether or not reliance exceeds expectation. If the answer is no, then the causation argument cannot be used to attack the propriety of awarding reliance damages in excess of expectation loss. Other arguments must justify the conclusion that reliance is the interest that should be protected unless reliance loss exceeds expectation loss.

Consider the following simple cases:

Case I. Buyer and Seller enter into a contract for the sale of ten widgets for a total price of \$50, delivery to be made two months later. The market price for these widgets at the time of the formation of the contract is \$55. Seller fails to deliver, and Buyer covers promptly at the reasonable market price of \$70.

Case II. All the facts are the same as in Case I except that the market price for the widgets at the time of contract formation is \$45 instead of \$55.

Placing the facts of the two simplified cases together for ease of comparison, we get:

	Case I	Case II
contract price	\$50	\$50
market price at time of formation	\$55	\$45
cover price	\$70	\$70
expectation measure	\$20	\$20
lost-opportunity reliance measure	\$15	\$25

In both Case I and Case II the argument for the expectation measure is the same. If Seller had delivered the widgets as promised, Buyer would have paid \$50 for them. Because of Seller's breach, Buyer had to pay \$70.¹¹⁰ In other words, Seller's breach caused \$20 of damage to

109. See *supra* notes 13-16 and accompanying text. At the time most reliance losses are incurred, the relying party does not expect to be reimbursed for these losses; rather, he hopes that the sum of these losses will be less than the sum of the benefits he will receive from the other party's performance. One can say that, but for the defaulting party contracting with the plaintiff, there would be no loss. In this sense, however, there is shared responsibility, since if the plaintiff had not contracted with the defendant, there would have been no loss either. From this point of view, the defendant was no more responsible than the plaintiff for the loss.

110. Using actual cover prices makes the calculation of the expectation loss as simple as possible. If Buyer had not actually covered, the expectation measure would be the difference between the contract price and the market price at the time and place that Buyer learned of the

Buyer.¹¹¹ While the expectation measure is the difference between the contract price and the cover price, the reliance measure might be seen as the difference between the market price at the time of contract formation and the cover price—that is, \$15 in Case I and \$25 in Case II. The argument is that if Seller had not come along then Buyer would have paid the existing market price, but because of Seller's promise Buyer had to pay \$70. Thus, Seller's promise and breach caused \$15 (Case I) or \$25 (Case II) of damage to Buyer.¹¹²

Although the two cases are theoretically parallel, the assumption that true reliance loss is measured by the difference between the market price and the cover price is more likely to be warranted in Case I than in Case II. It is reasonable to conclude that in most cases if Seller had not offered Buyer a below-market price, Buyer would have had to resort to the less advantageous market price. On the other hand, it is less likely to be true that if Seller had not offered Buyer an above-market price, Buyer would have contracted at the more advantageous market price. In the latter situation, Buyer would not have contracted with Seller if Buyer had known what the market price was. Can we say that if Seller had not made her offer, Buyer would have discovered a better one?

It thus seems less likely in Case II that Buyer would have contracted at the market price if Buyer had not contracted with Seller. Therefore, a decision to award \$15 in Case I but not to award \$25 in Case II might be based on the suspicion that the true reliance loss in Case II was not \$25 (but perhaps \$20, based on the assumption that if Buyer had not contracted with Seller at \$50, he would have contracted with someone else at \$50).

Cases I and II can fairly be distinguished. In Case I the defaulting Seller made a promise to the Buyer that was more advantageous to the Buyer than those available elsewhere. Awarding only the reliance loss

breach. See U.C.C. § 2-713 (1978). Buyer need not use the money to purchase the widgets. A court will be satisfied as long as Buyer had the ability to purchase the promised widgets. In all cases, I am assuming away all transaction costs and incidental losses.

111. The reference here is to "causation" in a factual, as opposed to a legal, sense. The test of causation has been variously described, but the basic idea is captured by the phrase "but for"—but for the causal event, the result would not have occurred. See, e.g., Mather, *supra* note 107, at 34 n.52; see also D. DOBBS, *supra* note 97, at 148-50. Using the "but for" test, it follows from the facts in the text that "but for" Seller's breach, Buyer would not have lost \$20.

112. Notice that the assumption underlying the lost-opportunity reliance calculation might be wrong. In Case I the assumption is that if Buyer had not contracted with Seller, Buyer would have paid the higher \$55 market price for the widgets. In Case II the assumption is that if Buyer had not contracted with Seller, Buyer would have paid only the \$45 market price for the widgets. If either assumption is wrong as a factual matter, then the calculation of the true reliance loss is wrong.

requires Seller to protect Buyer from all harm resulting from Seller's making and later breaking her promise, but does not require Seller to preserve for Buyer the extra advantage Seller promised. In Case II the defaulting Seller made a promise to the Buyer that was less advantageous to the Buyer than those available elsewhere. Awarding only the expectation loss requires Seller to protect Buyer from all harm resulting from Seller's breach, but does not require Seller to pay the difference between her promise and the more advantageous (to Buyer) alternative price. In simpler terms, Seller does not have to pay extra for her own bad deal, and she does not have to pay for Buyer's bad deal either.

C. Summary

To summarize, in some situations¹¹³ appealing arguments can be made for awarding reliance damages that exceed expectation, even though doing so would place the plaintiff in a better position than if the defendant had performed. But even those sympathetic to the reliance measure would probably agree that in many cases of contract breach it is hard to justify awarding more than expectation damages. We must then ask whether the conclusion that the expectation measure often should act as a ceiling on reliance damages casts doubt on the theoretical proposition that the goal of contract damages should be to protect the reliance interest. In my view, when the case in which reliance exceeds expectation is compared with the more usual situation in which reliance is less than expectation, the two cases appear sufficiently different to justify different remedial treatment.¹¹⁴

IV. Implementing the Lost-Opportunity Reliance Measure

The fundamental question we have been attempting to answer is this: What, ideally, should be the goal of contract remedies? Should it be to remove the negative effects on the plaintiff when a contract is made and then broken? Or should it be to ensure that the plaintiff receives the equivalent of what was promised to him in the contract? I have argued

113. See, e.g., *supra* text accompanying notes 99-103 & 105.

114. Consistency, like equality, is an elusive concept that lacks content until it is determined whether the similarities or the differences are more important for purposes of comparison. See Westen, *The Empty Idea of Equality*, 95 HARV. L. REV. 537 (1982).

For example, it is possible to argue that the expectation measure has an analogous consistency problem. The expectation measure attempts to place the plaintiff in the position he would have occupied had the contract been performed. But few would argue that the expectation principle should be followed if the breach benefited the plaintiff, since that would require the innocent party to pay damages. Does a zero floor on recovery cast doubt upon the selection of the expectation principle as the goal of contract damages?

that we should not employ state power to force a defaulting promisor to do more than place the promisee in the position he would have occupied had the promisor never made the promise in the first place.¹¹⁵ However, before concluding that courts should adopt the lost-opportunity reliance measure in place of the expectation measure as the standard remedy for breach of contract, we must consider whether such a change would entail added costs that might outweigh the benefits.¹¹⁶

A. Calculating Expectation and Lost-Opportunity Reliance Damages: Problems of Valuation

(1) *The Expectation Measure*

Placing a value on lost expectation resulting from breach of contract requires a headlong plunge into the world of the subjunctive. Judges must determine how much better off (than he is now, after the breach) the plaintiff would have been had the contract been fully performed. This inquiry can be broken down into three parts: 1) What would have been the value to the plaintiff of the defaulting party's performance? 2) What incidental and consequential losses would have been avoided? 3) What savings did the plaintiff realize by not having to complete his own performance of the contract?

It is often difficult to determine what the value to the plaintiff of the

115. See *supra* text accompanying notes 33-36.

116. It should be noted that the discussion of problems in valuing the expectation measure deals with the theory of the expectation measure (*i.e.*, how much money is necessary to place the plaintiff in the position he would have occupied had the contract been performed). In practice, of course, courts employing the expectation measure often place limitations on it so that even a plaintiff who is successful in urging an expectation claim will not be as well off as he would have been if the contract had been performed. He will not recover his attorney's fees or other costs of litigation, damages not reasonably foreseeable by the defendant, damages not provable with a reasonable degree of certainty as to amount, or damages that he could have avoided through reasonable efforts. At least one commentator has pointed to this failure to protect the true expectation interest as a justification for awarding supercompensatory damages in contract. See Farber, *Economic Efficiency*, *supra* note 49, at 1445.

Similarly, the analysis of valuation problems presented by the lost-opportunity reliance measure assumes the pure form of the reliance goal (to put the plaintiff in the position he would have occupied had there never been a contract with the defendant), and not the reality of how courts implement the measure. In practice, courts employing the reliance measure generally restrict themselves to out-of-pocket losses (disregarding the concept of lost opportunity), and even then award only those losses that were incurred reasonably or could not reasonably have been avoided.

A discussion of the doctrines limiting contract damage recoveries in expectation and reliance is beyond the scope of this Article. It should be recognized, however, that there is a danger that the theoretical analysis and argument for the reliance measure will be used to justify the real-life reliance option that falls far short of protecting the true reliance interest. The following subsection examines only the valuation problems inherent in the efforts to protect the theoretical (full) expectation or reliance interests.

defendant's performance would have been had there been no breach. The degree of difficulty depends upon the type of transaction and whether the defaulting party is the buyer or the seller.¹¹⁷ If the buyer is the defaulting party and was to purchase with money, then there is no valuation problem and the value of the defaulting buyer's performance to the seller is the unpaid contract price. But if the buyer was to purchase with services or goods or anything other than money, the difficulty of valuation depends upon the existence of a market for the consideration the buyer was to have furnished. If there is a market for the consideration, the value to the seller of the buyer's performance is that market value.¹¹⁸ If the seller is the defaulting party, the magnitude of the valuation problem will depend again upon whether a market exists for the items to be sold. If there is no market—if the items are unique—then the judge must face the difficult task of coming up with a monetary value to the buyer of the seller's performance that was promised but not delivered.

In addition to losing the value of the defaulting party's performance, the victim of a breach of contract may suffer other losses that would not have occurred had the contract been performed. Such "incidental" or "consequential"¹¹⁹ losses might include expenses of cover or resale, or other out-of-pocket expenses incident to the breach, as well as lost profits on resale, personal injuries caused by breach of warranty, or other losses incurred in consequence of the breach. To the extent that these losses can be characterized as "out-of-pocket," they generally are easier to value than lost gains, although the court still must be convinced that these losses would not have been incurred had the contract been performed.

117. Eisenberg, *supra* note 6, at 788-98. Whether the type of transaction affects the difficulty of measuring expectation loss depends primarily upon where the object of the contract falls on the continuum between unique items at one extreme and completely fungible commodities at the other. The more nearly unique the subject matter of the contract, the more difficult it is to place a value on its loss.

118. Although the seller may value the consideration itself above its market value, he, by definition, will not value the furnishing of that consideration more highly than the price (including transaction costs) at which he could obtain that consideration elsewhere.

119. The term "incidental damages" is used in the Uniform Commercial Code to refer to expenses reasonably incurred by the victim of a breach as a result of the other party's breach. *See* U.C.C. §§ 2-710, -715(1) (1978). The term "consequential damages" is used in the Uniform Commercial Code to refer to losses suffered by the victim of a breach (apparently limited to an innocent buyer) as a result of the seller's breach which could not reasonably have been prevented by cover or otherwise. *See id.* § 2-715(2). Although the definitions are vague, apparently the distinction between incidental and consequential damages is basically the difference between expenditures and other kinds of losses (not including the contract price/market price differential).

Finally, under the expectation measure, courts must inquire whether the plaintiff realized any savings that he would not have realized if the contract had been performed. The most important item in this category is usually the value to the plaintiff of not having to perform his side of the contract. As was the case for valuing the defaulting party's performance, valuing the nondefaulting party's performance may be easy if that performance is the payment of money. If, for example, the seller commits a breach, and the buyer for money has not fully performed, the value of performance saved will be the unpaid contract price. If the buyer has breached and there is a market for the items to be sold, the value of performance saved will be the market price (or the resale price) of the items not delivered.

(2) *The Reliance Measure*

The primary reason that judges give for invoking the reliance measure is the difficulty of placing a value on lost expectation.¹²⁰ The reliance measure generally employed, however, is not the theoretical reliance measure (giving full effect to lost opportunity), but rather an out-of-pocket losses formula.¹²¹ A reliance measure limited to out-of-pocket expenditures usually presents relatively minor valuation problems. Although cases sometimes present losses that are difficult to value (*e.g.*, injuries suffered because of breach of warranty),¹²² judges do not have to explore the world of what might have been. Although in some situations the expectation figure will be easier to determine than the out-of-pocket reliance figure,¹²³ in many cases the reason for choosing the out-of-

120. *See, e.g.*, *Hector Martinez & Co. v. Southern Pac. Transp. Co.*, 606 F.2d 106, 108 n.3 (5th Cir. 1979); *Kizas v. Webster*, 532 F. Supp. 1331, 1332 (D.D.C. 1982), *rev'd on other grounds*, 707 F.2d 24 (D.C. Cir. 1983); *Johnson v. Healy*, 176 Conn. 97, 106, 405 A.2d 54, 59 (1978); *Sullivan v. O'Connor*, 363 Mass. 579, 586, 296 N.E.2d 183, 188 (1973); *Earl Dubey & Sons v. Macomb Concrete Corp.*, 81 Mich. App. 662, 679-80, 266 N.W.2d 152, 160 (1978). *See generally* Hudec, *Restating the "Reliance Interest,"* 67 CORNELL L. REV. 704 (1982).

121. *See, e.g.*, *L. Albert & Son v. Armstrong Rubber Co.*, 178 F.2d 182, 188-89 (2d Cir. 1949); *H.M.O. Sys., Inc. v. Choicecare Health Servs., Inc.*, 665 P.2d 635, 639-40 (Colo. App. 1983).

122. The difficulties involved in measuring reliance losses are basically the same as the valuation difficulties in determining tort damages. When courts in tort cases go beyond compensation for losses incurred to compensate for gains prevented, valuation problems become more difficult. *See generally* Leubsdorf, *Remedies for Uncertainty*, 61 B.U.L. REV. 132 (1981).

123. The clearest case is when the lost expectation is a sum of money. For example, consider the case of a real estate broker who spends weeks tracking down a piece of property for buyer *B*, then sets up the deal and, at the last minute, *B* refuses to pay the commission. Determining the broker's reliance damages attributable to the weeks of wasted effort might be both difficult and speculative, but his expectation damages (*i.e.*, his commission) are known with certainty.

pocket reliance measure is precisely because it presents fewer valuation problems.

When the concept of lost opportunity is included in the reliance measure, reliance becomes even more difficult to value than expectation in precisely those cases in which courts seek an alternative to the difficult expectation measure. First, consider the problem of valuing lost performance. For expectation, we had to ask the hypothetical question: What would have been the value to the plaintiff of the defendant's completed performance of the contract? Under a lost-opportunity reliance measure, the question again must be posed in the subjunctive: What would have been the value to the plaintiff of the performance of the alternative contract, if any, that the plaintiff would have entered into had he not entered the contract with the defendant? This question generally will be more difficult to answer than the expectation question. Although both questions are hypothetical ones, for lost-opportunity reliance we must value the loss of performance of a (hypothetical) forgone contract rather than of the actual contract that was formed and then broken.¹²⁴

The valuation of the lost expectation of the forgone contract involves all the same difficulties that are involved in the search for the value of the lost expectation of the original contract, as well as a number of additional problems. To value the expectation of the nondefaulting party if he had not entered into the broken contract, we must determine whether another opportunity did in fact exist for the nondefaulting party. If so, was he aware of it? Would he have taken that opportunity if he had not contracted with the defendant? What would the terms of that alternative contract have been? Would the other party to the alternative contract have performed?¹²⁵ All these questions must be answered to arrive

124. I am using the term "hypothetical," here and elsewhere in this Article, to mean "not having occurred in fact." For example, an "actual" cost or loss is one that has been incurred or suffered in the real world. Actual costs or losses may present severe valuation problems, but they do not require any speculation about the probability of occurrence. "Hypothetical" costs or losses are those that might have been incurred or suffered had things in the real world happened differently, or those that might occur in the future.

125. The issue of whether an alternative contract would have been performed raises further complications. If our theoretical goal is full protection of the lost-opportunity reliance interest, then we must ask what benefit the plaintiff would have derived from the contract he would have entered into if he had not contracted with the defendant. If the alternative contractor would not have performed either, then presumably the plaintiff has not lost anything more than he would have lost had he never contracted with the defendant—that is, lost-opportunity damages would be zero.

Assume, however, the existence of a third opportunity that the plaintiff would have contracted for had he not contracted with the defendant or the first alternative contractor. Assume further that the damages measure to be applied is the lost-opportunity reliance measure. Under these assumptions, had the plaintiff contracted with the first alternative contractor (who

at a figure for the lost expectation of the forgone contract; fixing a figure for the lost expectation of the contract that was actually formed (and then broken) is far less difficult by comparison.

The concept of lost opportunity similarly complicates valuing incidental and consequential reliance damages. These damages consist of losses (other than the lost value of performance of the forgone contract) that would not have occurred if the plaintiff had not contracted with the defendant.¹²⁶ Under a lost-opportunity reliance measure, lost gains, as well as out-of-pocket losses, must be considered. For example, consider consequential damages consisting of profits lost by a retail store because of a construction company's failure to meet a contractually established completion deadline. These lost profits would constitute part of the store's lost expectation, assuming that they would have been earned had the contract been performed as promised.¹²⁷ A reliance measure based on out-of-pocket expenditures would avoid the difficult task of valuing these lost profits.¹²⁸ But a lost-opportunity measure would consider the possibility that the store would have contracted with another construction company if it had not contracted with the defendant, and lost profits would reenter the calculation. The only difference between the lost-opportunity reliance calculation and the lost-expectation calculation is that the former requires the additional step of determining what the terms of the alternative contract would have been. Thus, incidental and consequential damages are at least as difficult, and often more difficult, to calculate under a lost-opportunity reliance measure than under an expectation measure.

also would not have performed) the plaintiff would have been entitled to damages from the first alternative contractor based on the value of the lost opportunity to contract with the second alternative contractor. Thus, if a lost-opportunity measure is in place, the plaintiff should be entitled to the value of the lost opportunity if any alternative contractor would have performed, but would be denied the value of the lost opportunity if all alternative contractors would not have performed (*i.e.*, when some external intervening event makes it impossible for anyone to fulfill a contract similar to the one breached). *See* Cooter & Eisenberg, *supra* note 7, at 1445.

126. This proposition results from a simple adaptation of the definitions of incidental and consequential damages, *see supra* note 119, from the expectation measure to the reliance measure.

127. It should be kept in mind, of course, that saying that these lost profits constitute part of lost expectation does not necessarily mean that they will be recoverable under an expectation measure. Recoverable expectation damages may be limited by the concepts of foreseeability, certainty, mitigation, and other limiting doctrines. *See supra* note 116.

128. In fact, avoidance of the need to calculate lost profits is one of the main reasons that courts invoke the reliance measure. Courts find it convenient to resort to the reliance measure when the "lost profits" are too uncertain to be calculated fairly and accurately. *See supra* notes 120-23 and accompanying text.

The same conclusion applies to the calculation of savings realized because of breach. Since the goal of the lost-opportunity reliance measure is to approximate the position that the plaintiff would be in had he entered into an alternative contract, we must subtract from the benefit he would have received under that contract the costs that he would have incurred. The most important of these costs is the cost of the plaintiff's own performance of the alternative contract. This cost was averted when the plaintiff contracted with the defendant instead of entering into the alternative contract. This figure is a hypothetical one, but so is the corresponding figure under the expectation measure. There is, however, an added level of speculation involved here that is not involved under the expectation measure. Under expectation, the terms of the contract are established, and the only question concerns the value to the nondefaulting party of not having to complete performance under those terms. But in the case of the forgone contract, we must first speculate about the terms of the forgone contract and then ask what the value is to the nondefaulting party of being relieved of the obligation to perform those terms.¹²⁹

To summarize, a comparison of the valuation problems involved in calculating the expectation measure and the lost-opportunity reliance measure reveals that, although both measures often require answers to difficult hypothetical questions, the lost-opportunity measure presents an additional layer of problems not involved in the expectation measure. For expectation, we must figure out the position that the plaintiff would have been in had the contract between the plaintiff and the defendant been performed. For lost-opportunity reliance, we have to speculate about the terms of a contract (if any) the plaintiff would have entered into had he not contracted with the defendant. Only after we have attempted this difficult task can we turn to the expectation question of what position the plaintiff would have been in had this alternative, forgone contract been performed.

The discussion of valuation problems in this section suggests that a key factor in determining how difficult it will be to measure both expectation and lost opportunity is the extent to which there is a market for the items to be exchanged. The following propositions should be evident:

129. I am assuming here that the failure of one party to perform the contract will excuse the other party's duty to perform. Although this is generally the case, I should note here my recognition that it is possible to have independent promises such that each party's failure to perform subjects him to damages but does not terminate the other party's duty to perform. See, e.g., J. CALAMARI & J. PERILLO, *supra* note 97, at 432; 3A A. CORBIN, A COMPREHENSIVE TREATISE ON THE RULES OF CONTRACT LAW §§ 637, 654 (1960); 6 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 813 (3d ed. 1962).

As the market for the items to be exchanged improves: (1) it becomes easier to calculate lost expectation; (2) it becomes easier to calculate lost opportunity; and (3) the difference between the two measures decreases (until, under perfect market conditions, they are the same).

At this point, Fuller and Perdue's argument that the expectation measure is best defended as an attempt to approximate the lost-opportunity reliance measure¹³⁰ (what Eisenberg calls the "surrogate cost" argument)¹³¹ seems persuasive. For the lost-opportunity measure to be applied as a realistic alternative to the expectation measure, there must be some certainty in identifying and quantifying the lost opportunity. Usually this means that there must be a market for the subject matter of the contract. But if there is a market, the expectation measure is a good approximation of the lost opportunity. Conversely, lost opportunity differs significantly from lost expectation only when there is no market, or a poorly functioning market, and in that event the value of the lost opportunity becomes problematic.

Are there exceptions to these generalizations? Are there any circumstances in which the expectation and lost-opportunity reliance measures are significantly different, and in which that difference can be determined with reasonable confidence and without prohibitively high costs? Are there situations in which the lost-opportunity reliance measure should be considered not just as a theoretical goal, but also as the preferable measure of damages in actual cases? The next subsection discusses the possibilities for practical use of the lost-opportunity reliance measure.

B. Possible Uses of the Lost-Opportunity Reliance Measure

For the lost-opportunity reliance measure¹³² to be a practical alter-

130. Fuller & Perdue, *supra* note 1, at 60-66.

131. Eisenberg, *supra* note 6, at 787.

132. In their excellent and illuminating article, Cooter and Eisenberg set forth their views on when courts should employ the expectation measure and when they should resort to the reliance measure. Cooter & Eisenberg, *supra* note 7, at 1459-75. They recognize that reliance protection and administrative considerations provide much of the support for the expectation measure. But they go on to say that reasons of fairness and efficiency generally support use of the expectation measure even when it differs significantly from the reliance measure. *Id.* at 1475. This is where we part company. Their efficiency argument seems to be not much more than the efficient-breach argument made by many others and criticized in this Article. *See supra* section II.B(1). Their fairness argument is based on the notion that courts should generally award the amount of damages that the parties themselves would have agreed to. In my view they do not make a convincing case that parties would agree to expectation damages when those damages would significantly exceed true reliance loss, if that loss could be calculated with reasonable ease.

In a section entitled "The Limits of the Expectation Principle," Cooter and Eisenberg give

native to the expectation measure rather than merely a theoretical construct, we must identify situations in which it is both feasible and worthwhile to implement it. At a minimum, the additional costs of calculating the value of lost opportunity must be less than the difference between the lost-opportunity and expectation measures. At least three types of situations might meet this criterion. The first is when it is possible to point to a specific offer or offers that the plaintiff declined because of the defendant's offer. The second situation involves a sale or exchange of something having a generally recognized market price, but in which the contract price deviates significantly from the market price. The third situation is one in which we can be reasonably confident that the value of the lost opportunity is zero, either because the breach follows the promise so quickly or for other reasons. Although these three transaction types are not mutually exclusive, for purposes of analysis they will be discussed separately.

(1) *Specifically Identifiable Forgone Contracts*

Assume that a contractor submits a bid for construction work in response to a widely disseminated solicitation from a developer. This bid turns out to be the lowest of the several otherwise equivalent bids, and the developer notifies the contractor that her bid has been accepted. A month later, the contractor discovers an error in the calculation of her bid, and attempts to withdraw the bid. The developer refuses to allow the withdrawal, and informs the contractor that he will hold the contractor to her original promise. The contractor then repudiates the deal. The developer hires someone else to do the job and sues the contractor for damages.

Assume that the contractor's bid was \$80,000, the next lowest bid was \$100,000, and the price under the replacement contract (the lowest price obtainable at the time the developer learned of the contractor's repudiation) was \$110,000. Both the lost expectation (\$30,000)¹³³ and the

two examples of situations in which expectation damages should not be awarded. Cooter & Eisenberg, *supra* note 7, at 1471-75. Both involve consumer-defendants. Although I agree with the authors' suggested results in those cases, I find some of the analysis distinguishing those cases from similar commercial cases unpersuasive. Cooter and Eisenberg strive to save the expectation principle as the goal of contract remedies by distinguishing away cases in which the principle yields particularly harsh results. My approach is to say that the only reasons for preferring expectation are administrative ones, and that we should not hesitate to abandon expectation whenever we are reasonably sure that it has ceased to be the best way to protect reliance. See also Eisenberg, *supra* note 6, at 785-98; *supra* note 84 and accompanying text.

133. The expectation measure would be the difference between the amount of the original

lost opportunity (\$10,000)¹³⁴ are easily calculable. Under these facts, the greatest practical obstacles to use of the lost-opportunity measure are removed. Here we know: (1) that an alternative opportunity existed and what the terms of that opportunity were; (2) that the plaintiff-developer knew about that opportunity and probably would have taken advantage of that opportunity had it not been for the defendant-contractor's lower bid; and (3) that performance of that forgone contract would have yielded a benefit to the developer when compared with what that developer actually had to do. All these normally difficult conclusions follow rather easily from the fact that another acceptable bid was submitted for the same work.¹³⁵ Even under these facts, however, to award the \$10,000 reliance loss the court may have to assume that the next lowest bidder would have performed fully if her bid had been accepted.¹³⁶

What objections can be made to the choice of the lost-opportunity measure over the expectation measure in this mistaken-bid situation?¹³⁷ One argument is that the reliance measure will reduce the incentive for people submitting bids to make sure that those bids do not contain any mistakes. But how much deterrence do we want in this situation? Assuming that those submitting bids will respond to incentives created by damages levels,¹³⁸ presumably we would want to deter mistakes up to the point at which the cost of avoiding them equals the amount of loss caused by them. But we then have to decide what we mean by "loss." Does "loss" include lost expectation or only losses measured against the status quo ante? We have thus merely restated the original question.

A fairness argument could be made that since it was the contractor

bid (\$80,000) and the amount the developer had to pay after breach (\$110,000). The \$30,000 figure assumes there were no incidental or consequential damages.

134. The lost-opportunity reliance measure would be the difference between the amount of the next lowest bid (\$100,000) and the amount the developer had to pay after breach (\$110,000). Again, I am assuming there were no incidental or consequential damages, and no psychological harm resulting from the original bid and its breach.

135. *But see* Comment, *Once More into the Breach: Promissory Estoppel and Traditional Damage Doctrine*, 37 U. CHI. L. REV. 559, 569-71 (1970) (pointing out the dangers of applying the lost-opportunity analysis to the subcontractor's-mistaken-bid situation).

136. Theoretically, the \$10,000 figure would have to be discounted by the probability that the next lowest bidder would have defaulted, unless you assume that lost-opportunity reliance damages would be recoverable for that breach, in which case you would have to consider the third lowest bid—and so on. *See supra* note 125 and accompanying text. In most cases, however, there would be no satisfactory way to arrive at such a probability figure. Unless there is a reason to suspect that this particular party would not have performed if he had been awarded the contract, this factor probably should be ignored, and the nondefaulting party should receive the full value of the lost opportunity.

137. Edward Yorio explores the same question in Yorio, *supra* note 60, at 1422-23.

138. *See supra* text accompanying note 74.

who made the promise and the mistake, the contractor should bear the loss resulting from the mistake. Even accepting this argument, however, we again must determine what is meant by "loss." It seems "fair" to make the contractor restore the developer to the position he would have been in had the contractor not submitted a bid in the first place, but not to award the developer a remedy that would place him in a better position than he would have been in had there been no mistake. Thus in the mistaken-bid situation the difficulties of calculating the lost-opportunity remedy are sufficiently removed to warrant its selection if one chooses reliance as the theoretical goal of contract remedies.

The mistaken-bid situation is not the only one in which it might be possible to identify with some confidence the "next best offer." If there is sufficient evidence to establish the existence of this available alternative, there is no reason why the result should be different just because there was no formal solicitation of bids. On the other hand, a damages measure based on a determination of the amount of the next best offer might lead to difficult problems of proof. For example, assume that expectation were to remain the standard measure of contract damages, but that a lesser lost-opportunity reliance award would be substituted if the defendant could prove with some reliability the existence and amount of the lost opportunity. Although the defendant would have the burden of proof, it would be the plaintiff who would have the relevant information. Under these circumstances, the plaintiff would have an incentive to withhold information about other offers he had received.

To illustrate, assume that P as seller and D as buyer enter into a contract for the sale of a used car for \$500. Further assume that P had another offer for the car from Q , who offered to pay \$450. D fails to keep her promise to pay \$500 to buy the car, and P is able to resell the car for \$400 after learning of D 's breach. The lost expectation amount is \$100, and the lost-opportunity reliance amount is \$50. Thus it would be the defendant who would seek to prove that the plaintiff had received the \$450 offer. Not only is this difficult for the defendant to do, but the temptation it creates for the plaintiff to conceal the existence of other offers makes one wonder whether it is worth the costs to employ a standard based on proof of the existence and terms of offers that were never accepted.

If recovery of lost opportunity greater than lost expectation is allowed,¹³⁹ the administrative problems may be even more troublesome. Although in such a situation it would be the plaintiff who would seek to

139. See *supra* section III.

prove the existence and terms of the forgone opportunity, and the plaintiff would have the information, there would be a danger of false testimony of offers not really made. Thus, although in general the lost-opportunity measure can be both administratively feasible and desirable outside of the formal solicitation-of-bid situation, we should be alert to the potential problems involved in calculating damage awards based on the value of specific forgone offers.

(2) *Substantial Deviation of Contract Price from Market Price*

Another situation in which it might be feasible to employ the lost-opportunity measure is when the contract price deviates significantly from the market price. The reasons for the contract-market divergence may have a significant effect on our inclination to award that differential to the plaintiff. For example, if a buyer agreed to pay more than the prevailing market price for an item, we may want to know whether the seller was simply a shrewd negotiator, the buyer chose not to shop around, the buyer placed a special trust in this particular seller, or the buyer had all the relevant information about the market but interpreted it incorrectly.

Cases involving significant divergence between the contract price and an established market price can be viewed as involving a "mistake" in underlying assumptions. At least one party is probably mistaken about the market price. In some cases of knowing advantage-taking, a refusal to enforce the contract may be the most appropriate action. Assume that a knowledgeable antique dealer goes to a yard sale and spots a valuable piece of antique furniture for which there is an established market price of approximately \$5000. The dealer offers to buy the antique for \$50, and the unknowing homeowner agrees. Before the seller delivers the antique, she discovers its true value and repudiates the contract. Traditional mistake theory might allow the seller in these circumstances to rescind the agreement.¹⁴⁰

By changing the facts, we can reduce our sympathy for the party

140. Comment b to § 152 of the Second Restatement of Contracts (dealing with mutual mistake) states: "generally, mistakes as to market conditions or financial ability do not justify avoidance under the rules governing mistake." Section 153 (dealing with unilateral mistake) allows a mistaken party to avoid a contract if the mistake goes to a basic assumption of the contract and has a material effect on the agreed exchange adverse to him, he has not accepted the risk of the mistake either impliedly or explicitly, and either the enforcement of the contract would be unconscionable or the other party had reason to know of the mistake or actually caused the mistake. In this particular hypothetical, the mistaken seller might succeed under § 153, even though the mistake arguably goes to the market price of the furniture (which is traditionally not protected by the mistake defense), since the buyer knew, or should have known, that the seller was making a mistake.

making the bad deal. Assume that the negotiations are between two antique dealers; one dealer believes the item of furniture may turn out to be one of exceptional value, and the other fails to recognize the value of what he is selling. What should we do when the seller discovers that he has made a mistake which, as an expert, he should not have made? Here, excusing performance because of mistake seems harder to justify, but some would argue that if the buyer had reason to believe that the seller was making a serious mistake, rescission would be appropriate.¹⁴¹ Others might respond that we should not rescue bad bargainers but rather reward good bargainers by awarding full expectation damages to the buyer.¹⁴² It seems to be a fair compromise to refuse to give full effect to the one-sided deal, but to require the defaulting seller to protect the buyer from any reliance loss caused by the seller's mistake.

Finally, assume that neither party suspected that the contract price deviated significantly from the market price, and that the parties had equal bargaining power. This situation probably presents the most controversial application of the lost-reliance principle instead of the expectation measure. Isn't one function of contract to allocate the risk of market misjudgment? After all, the contract price could turn out to have been either above or below the market price. Why use the market price as a basis for calculating damages when it is the contract price that the parties agreed to? My answer to these questions is that, even when one party has not knowingly taken advantage of another, society does not have a legitimate interest in implementing the private advantage of one citizen at the expense of another.

It should be noted that difficulties may arise in determining whether the contract price really does deviate significantly from the market price. When we suspect that the buyer made a bad deal, we must be sure about what the "market value" of the subject matter of the contract really is. Some sellers may be more reliable than others, or other reasons may make the deal with this particular seller worth more to the buyer than the general market transaction would be. If it is the seller who made the bad deal, and the buyer is buying with cash, we do not have to worry as much about the value of the buyer's performance.

If we can determine at reasonable cost and with reasonable certainty that the contract price significantly deviates from a generally established

141. See RESTATEMENT (SECOND) OF CONTRACTS § 153 (1981); RESTATEMENT OF RESTITUTION § 12 comment c, illustration 8 (1937); see also Eisenberg, *supra* note 6, at 778-85.

142. See RESTATEMENT OF RESTITUTION § 12 comment c, illustration 9 (1937); see also Kronman, *Mistake, Disclosure, Information, and the Law of Contracts*, 7 J. LEGAL STUD. 1 (1978).

and recognized market price, lost-opportunity reliance provides an appropriate measure of damages for breach.

(3) *Breach Without Reliance Loss*

A third category of cases in which the expectation and lost-opportunity reliance measures might differ significantly consists of situations in which we can be reasonably sure that the victim of the breach of promise has not suffered any reliance loss.¹⁴³ Assume that *X* signs a contract to buy a set of encyclopedias from *Y*, but changes her mind thirty seconds later and asks *Y* to tear up the contract. Not only has neither party begun performance of the contract (the contract is "wholly executory"), but the repudiation came so quickly that we can conclude with some confidence that *Y* has not lost any opportunity or suffered any other reliance loss as a result of *X*'s promise and its repudiation. The lost-opportunity reliance measure would result in no damages for breach.¹⁴⁴ On the other hand, the expectation measure would require *X* to pay to *Y* the amount of *Y*'s profit on the encyclopedias if the sale had gone through.

This hypothetical presents a clear choice between the expectation and reliance measures of contract damages. Proponents of the expectation measure might argue that the parties know that the signing of the contract is the legally significant event that gives rise to their contractual responsibility, and thus the formation of the contract is the crucial point in time. Under a reliance measure, however, the parties (particularly the party contemplating breach) cannot be sure when the legally significant time occurs. It is often not easy to tell when the nonbreaching party has lost an opportunity. We are confident that there was no reliance loss in the encyclopedias hypothetical because of the extreme rapidity of the repudiation.¹⁴⁵ But other cases will not be as extreme, and courts will face

143. Eisenberg has argued that in wholly executory contract situations, we should not blindly adopt the expectation measure in all cases, but should search for justifications for awarding expectation damages. Eisenberg, *supra* note 6, at 785-98. He identifies three justifications for awarding damages for breach of wholly executory contracts. The first justification is protection against reliance loss. *Id.* at 787. He offers two additional justifications—facilitating planning and allocating risk—but does not develop them sufficiently to explain what they add to the surrogate-cost justification. Eisenberg attempts to illustrate when each of his justifications is persuasive and when it is not by identifying four factual variables to look for in particular cases. Eisenberg's discussion is interesting and instructive, but it is not intended to exhaust the possible relevant variables nor the ways in which the variables he does identify affect the presence or absence of reliance loss.

144. The victim of the breach would be no worse off than if no promise had been made, except, perhaps, for psychological harm. See *supra* notes 8-9 and accompanying text.

145. It may be possible to be confident about the lack of lost opportunity even without an immediate repudiation. The hypothetical of the photographer at the road race may be an example. See *supra* text accompanying note 31.

the difficult task of determining whether in fact an opportunity has been lost. The expectation measure avoids this speculative inquiry and thus provides a clearer and more understandable measure of liability for breach of contract. The reliance measure weakens the message of the law that the making of a promise is a solemn and important undertaking.¹⁴⁶

Although this argument for the expectation measure has some force, it overstates the distinction between the two remedies. In the first place, under a reliance measure the signing of the contract is still the trigger to liability. It is a prerequisite to liability for the reliance measure in the same sense as it is for the expectation measure. It is simply not the only requirement for liability; a reliance loss must follow the formation of the contract. Of course, under the expectation measure the signing of the contract is not the only requirement for liability either; there must be a loss of profit or other expectation in order for the defaulting party to be liable. Under either measure, it is possible to break a solemn promise without being liable to the promisee. Under both measures, it is the occurrence of "loss" and not the mere formation and breach of a contract that ultimately gives rise to liability.

The fact remains, however, that it often will be difficult to determine whether the promisee has suffered a loss of opportunity after a breach by the promisor. Because of this uncertainty, and because the expectation measure often provides a good estimate of lost opportunity,¹⁴⁷ it is tempting to employ the expectation measure in all executory contract situations for purposes of ease of administration and consistency, even if it results in overcompensation in some cases.

However, if one believes in the principle that contract liability should be measured by the amount of reliance loss, the question is whether the added predictability and simplicity of the expectation measure offset the reduced accuracy that results when expectation is used as a surrogate for reliance loss measurement. Although predictable liability rules are valuable, it is doubtful whether many parties contemplating breach of contract actually undertake a careful calculation of the amount of damages payable if the matter is taken to court and liability is imposed.¹⁴⁸ Those parties who do take the time and effort to make such a calculation could probably make a good estimate of lost-opportunity damages as well.

One response to the problem of determining whether the costs of

146. See C. FRIED, *supra* note 32, at 19.

147. See *supra* notes 33-34 and accompanying text. See generally *supra* subsection IV.A.

148. See generally Macauley, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55 (1963).

calculating lost opportunity outweigh the benefits of increased accuracy might be to place the burden of proof on the defendant to show that the lost opportunity is less than the lost expectation. Presumably, if the costs of proving the discrepancy outweigh the discrepancy itself, the defendant will not challenge the expectation figure.

V. Conclusion

The question addressed by this Article is a basic one: What should be the goal of remedies for breach of contract? In the 1930s, Fuller and Perdue concluded that the arguments for going beyond compensation for reliance loss to protection of expected gain were unpersuasive. Since then, legal scholars have advanced moral and economic arguments in support of the idea that protection against lost expectation should be the desired object of remedies for contract breach. This Article has examined those arguments and concludes that a convincing case still has not been presented for making protection of expectation the theoretical goal of contract remedies.

As Fuller and Perdue recognized, however, a powerful instrumental argument often supports the awarding of expectation damages.¹⁴⁹ Even if the proper theoretical goal is to protect the reliance interest, in a large number of cases the best way to compensate reliance loss is to grant an expectation award. An authoritative proclamation that from now on only the reliance measure of damages would be employed would create a danger of gross undercompensation of reliance loss because of the difficulty contracting parties and judges would have in recognizing and proving what the full reliance losses actually were.

On the other hand, it would be worthwhile to declare explicitly that protecting expectation is not the goal but simply a rough method of achieving the goal of protecting against reliance loss. If we are careful not to undervalue reliance loss, and if we conclude that in particular cases we can, without inordinate costs, come closer to compensating for reliance loss by a direct approach rather than by using the expectation measure as a surrogate,¹⁵⁰ then we should abandon the expectation measure and award the value of the reliance loss including any lost opportunity.

The only difference between the theoretical expectation measure and the theoretical lost-opportunity reliance measure is that the expectation measure awards to the plaintiff the extra advantage he would have re-

149. Fuller & Perdue, *supra* note 1, at 61-62.

150. See Eisenberg, *supra* note 6, at 787.

ceived from the defendant beyond what he would have received elsewhere.¹⁵¹ Those arguing for enforcement of this extra advantage have not demonstrated a compelling moral or economic justification for doing so. On the other hand, I have not constructed a compelling case for always protecting no more than the reliance interest. For me, the burden of proof should be on the party seeking to employ public power to enforce private advantage. My view reflects the belief, based only upon experience and intuition, that enforcing private advantage helps the strong at the expense of the weak—and the political conviction that using public power to accomplish only that result is undesirable.

151. See *supra* text accompanying notes 19-31.

