The Design of Contract Damages

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Key points

1. The jurisprudential foundation of contract damages is that damages compensate for the wrong of contract breach. Despite being accepted orthodoxy, this compensation principle is at odds with the purposes of many contracting parties.
2. Contract parties have a variety of reasons to prefer and choose remedies that deviate significantly from compensatory damages in order to promote their joint goals of litigation and performance incentives, and of risk allocation.
3. The law of contract remedies impedes the parties' autonomy to pursue these goals and should be reformed to free the parties from the tether of the compensation principle, subject to the usual protections under the doctrines of capacity, mistake, duress and unconscionability.

Damages as Compensation

For at least the past two centuries, contract law has viewed damages as *compensation* for a wrong inflicted by the breaching promisor on the promisee. Although this framing of contract remedies is attractive, it is too vague to be helpful. In particular, what is the promisee's loss that needs to be compensated? In the 1930s, contract scholars Lon Fuller and William Perdue suggested that, by breaching, a promisor takes the promisee's interest in the contract, which they categorised as restitution, reliance or expectation.[1] They argued that the reliance interest is the most worthy of protection and that, because it is often difficult to measure, the expectation interest often serves as an appropriate proxy. Fuller and Perdue's analysis is unclear as to what the promisee relies on in a contract. On the promise, surely, but this answer begs a new question: what did the promisor promise to do? Deliver the good or service in question under all circumstances? The intractability of this question is further demonstrated by Justice Oliver Wendell Holmes'

1 L Fuller and W Perdue, 'The Reliance Interest in Contract Damages' (1936) 46 *Yale LJ* 52.

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