TWO TYPES OF EXPECTATION INTEREST IN CONTRACT DAMAGES

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I. INTRODUCTION: THE DISCRETIONARY ELEMENT IN DAMAGES AWARDS AND THE GROWTH OF RULES AND PRINCIPLES

In many legal systems enforced performance (a judicial decree that the contract be performed in accordance with its terms) is the most important contractual remedy.[1] The tortious origins of the law of contract in Anglo-Australian law have given a place of special prominence to the action for damages for breach of contract (a court order to the defendant to pay compensation for his failure to comply with the terms of the contract).[2] In the early days of *assumpsit*, juries had a very wide discretion in their determination of the amount of money which the defendant should pay for his breach.[3] Some of this discretion still remains, although it now vests in the judge who has taken the place of the jury in most civil cases. Mr Justice Isaac's call (quoting the words of Lord Shaw) for "a sound imagination and the practice of the broad axe" in *Whitfield* v. *De Lauret & Co. Ltd*[4] has been echoed by Australian courts[5] and seems still appropriate to a range of issues in contractual damages actions.

This discretionary component in damages awards means that the role to be played by appeal courts is correspondingly limited. As long as the judge of fact has not ignored or misapplied a relevant rule or principle, an appeal

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1 See the comparative account given by G.Treitel, *Remedies for Breach of Contract* (1988), 43 *et seq.*

2 See the observations by Isaacs J. in *Whitfield* v. *De Lauret & Co. Ltd* (1920) 29 CLR 71, 80.

3 See the observations by Vaughan Williams L.J. in *Chaplin* v. *Hicks* [1911] 2 KB 786, 792; see also the comprehensive account of the history of the action in Washington (1931) 47 *LQR* 345 and (1932) 48 *LQR* 90.

court will interfere with an award only if it seems hopelessly too large or hopelessly too small.[6]

In due course this discretion became circumscribed with numerous rules and principles. In contractual actions damages are no longer completely 'at large'. In *King* v. *Ivanhoe Gold Corp. Ltd*[7] Griffith C.J. stated:

> [i]n an action for breach of contract there must be some measure of damages capable of being laid down to the jury; the question of damages cannot be left at large, as in an action for a personal wrong, such as defamation or assault.[8]

Broad principles to govern damages awards in breach of contract actions were laid down fairly early. Baron Parke formulated the compensatory purpose of such awards in a well-known statement in 1848:

> [w]here a party sustains a loss by reason of a breach of contract, he is, so far as money can do it, to be placed in the same situation, with respect to damages, as if the contract had been performed.[9]

This statement has been accepted without reservation by Australian courts.[10]

Baron Parke's principle could be read as calling for complete compensation for all detrimental consequences which might flow from a breach. So interpreted, its potential ambit would be very wide. A party who breaks a contract usually does so by denying the other party the benefit of a promised performance. That is prejudicial in itself, even if it has no further detrimental consequences. Usually however, there are further consequences: the breach tends to disrupt some course of action which had been planned in reliance upon the expected performance. The cases provide examples in abundance. One will suffice to illustrate the point. A travel agency failed to provide, in breach of contract, the full European holiday which it had promised. The client lost part of the expected holiday (loss of the promised benefit), but he also incurred much

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4 Note 2 *supra*, 81.

5 See observations by Mayo J. in *Gibbs* v. *Ellis* [1942] SASR 125, 127 *et seq.* and by Campbell J. in *Waters* v. *Maynard* (1924) 24 SR (NSW) 618, 622 *et seq.* Compare the more discreet admission by Dixon J. who said in the context of a torts case, "[t]o estimate the sum to be awarded involves the exercise of a form of discretionary judgment": *Lee Transport Co.* v. *Watson* (1940) 64 CLR 1, 13.

6 *Gibbs* v. *Ellis* note 5 *supra*, 127 *et seq.*, *per* Mayo J. See also *Athens-McDonald Travel Agency* v. *Kazis* [1970] SASR 264, 274-6, *per* Zelling J.

7 (1908) 7 CLR 617.

8 *Id.*, 620.

9 *Robinson* v. *Harman* (1848) 1 Exch 850, 855.

10 *King* v. *Ivanhoe Gold Corp.Ltd* (1908) 7 CLR 617, *per* O'Connor J.; see also *Holmes* v. *Jones* (1907) 4 CLR 1692, 1709 *per* O'Connor J.; *Driver* v. *The War Service Homes Commissioner* (1923) 44 ALT 130, 134 *per* Irvine C.J.; *Athens-McDonald Travel Service* v. *Kazis* note 6 *supra*, 270, *per* Zelling J.; *Commissioner for Railways* v. *Dangar* (1943) 15 LGR(NSW) 100, 108, *per* Herron J.; *Pennant Hills Restaurants Pty Ltd* v. *Barrell Insurance Pty Ltd* (1981) 145 CLR 625, 637, *per* Gibbs J.

further expense in making efforts to persuade the agency to adhere to the contract and in rearranging his personal and business affairs upon his premature return (consequential loss).[11] Yet further detrimental consequences can readily be imagined: the financial setback might cause bankruptcy, matrimonial problems or illness. A person's whole life can take a turn for the worse as a result of a breach of contract.

Complete recovery, for even the most remote consequences of a breach, is generally considered to be inappropriate.[12] In 1854 Baron Alderson, inspired by French jurisprudence,[13] announced a broad principle which consists of a number of criteria for excluding unduly remote prejudicial consequences from the ambit of recovery:

> [w]here two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made their contract, as the probable result of the breach of it.[14]

In general, this principle confines recovery to such items of loss as the parties, when they made their contract, could reasonably have foreseen as not unlikely consequences of a breach.

Like Baron Parke's principle, Baron Alderson's limitation of it has been accepted by Australian courts as axiomatic.[15] In England the rule (or rules) in *Hadley* v. *Baxendale* has been subject to much speculation, analysis, explanation and even restatement.[16] One may respectfully doubt whether this has done much to clarify the principle, but at least it seems that its authority has not been much impaired by the process.

II. THREE TYPES OF INTEREST IDENTIFIED BY FULLER AND PERDUE[17]

It is one thing to lay down broad policies for a complex range of practical problems. It is quite another to develop the concepts and distinctions which will best serve to translate those policies into such detailed rules as will lend the required certainty and predictability to the day-to-day

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11 *Athens-McDonald Travel Service* v. *Kazis* note 6 *supra*. Readers who prefer a more colourful example are referred to *Nettleship's Case* (1868) LR 3 CP 499, at 508, *per* Willis J. (loss of lucrative marriage due to delay caused by unskilful shoeing of horse).

12 *Cf. Victoria Laundry (Windsor) Ltd* v. *Newman Industries Ltd* [1949] 2 KB 528, 539, *per* Asquith L.J.

13 Washington, note 3 *supra*, 103 *et seq.*

14 *Hadley* v. *Baxendale* (1854) 9 Exch 341, 354 (hereinafter *Hadley* v. *Baxendale*).

15 See, for example, *Thompson* v. *Marshall* (1860) 3 WW & a'B (L) 150 and *Cooper* v. *Gardiner* (1902) 2 SR (NSW) 67.

16 See, for example, *Victoria Laundry* note 12 *supra* and *The Heron II* [1967] 3 All ER 686.

17 "The Reliance Interest in Contract Damages" (1936) 46 *Yale LJ* 52, 373 (hereinafter *Fuller and Perdue*).

operation of the law. The absence of the needed conceptual structure prompted Atkin L.J. to complain, as late as 1925, that the law of damages was less guided by authoritative and definite principles than almost any other area of the law, and to call for it to be given a "scientific statement".[18] A great advance towards such a statement was made in 1936 when Fuller and Perdue published their well-known article in the United States.[19] This contribution was destined to make a major impact upon theory and practice in the area of contract damages in common law countries. In 1978 Atiyah felt able to say that little else of value had been written about the fundamental reasons for the binding nature of bare promises and contracts in the 40 years since that celebrated article.[20]

Finding much of their inspiration in German jurisprudence,[21] the authors sought to identify and describe the various interests which a party suing for breach of contract might seek to assert. They suggested that the purpose of damages awards in such cases was to protect three legitimate interests which the plaintiff, depending upon the circumstances, might wish to assert:

(1) to have things of value returned which he might already have transferred to the defendant under the contract (restitution interest),
(2) to be compensated for any detrimental change in his position which he might have brought about - whether by performing his part of the contract or otherwise - in reliance upon the contract (reliance interest), and
(3) to obtain the value of the expectancy which the promise had created (expectation interest).

Here at last was the foundation for the scientific statement which Atkin L.J. had called for in 1925! The influence exerted by the article has deservedly been very great, not just in the United States but throughout the common law world. Major textbooks treat Fuller and Perdue's distinctions as fundamentally important.[22] In a recent decision the distinction between reliance interest and expectation interest was invoked with apparent approval by three justices of the High Court.[23]

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18 *The Susquehenna* [1925] P 196, 210; more than a decade later, Goodhart echoed Atkin L.J.'s sentiments - "Two Cases on Damages" (1937) 2 *UTLJ* 1.

19 Fuller and Perdue, note 17 *supra,* 373.

20 P.S.Atiyah, "Contracts, Promises and the Law of Obligations" (1978) 94 *LQR* 193, 214.

21 See the frequent references to the German Civil Code and to German legal authors in the article.

22 For the United Kingdom, see *Treitel on Contract* (6th ed., 1983), 706 *et seq.;* for Australia, see K.E.Lindgren, J.Carter and D.Harland, *Contract Law in Australia* (1986), 690 *et seq.;* D.W.Greig and J.L.R.Davis, *The Law of Contract* (1987) 1352 *et seq.; Cheshire and Fifoot's Law of Contract* (5th Aust. ed., 1988), 657 *et seq.*

23 *Gates* v. *City Mutual Life Assurance Society Ltd* (1986) 160 CLR 1, 12, *per* Mason, Wilson and Dawson JJ.

Without intending in any way to detract from the important role which Fuller and Perdue's analysis has been playing in improving our understanding of damages issues, it must be pointed out that their basic scheme suffers from a number of weaknesses and that some adjustments to it are necessary.

III. THE EXPECTATION INTEREST: RATIONALES FOR ITS PROTECTION

Fuller and Perdue acknowledge that, in actions for failure to perform, the courts usually award the value of the expectancy, the plaintiff's 'lost profit'.[24] However, whilst they ultimately claim to have found good reasons for this practice,[25] they commence their article by casting a good deal of doubt upon it. The opening argument asserts that, because the plaintiff has never had the benefit of the defendant's performance, he cannot have 'lost' it in any genuine sense. Thus, no fundamental principle of compensation for injury can be regarded as available to sustain recovery for loss of a contractual expectancy which "appears as a 'loss' only by reference to an unstated *ought*."[26]

This discovery of a normative element in "loss of an expectancy" is beyond reproach in itself, but the conclusion drawn from it ("not genuine loss") is a *non sequitur,* for such an element is a common feature of many types of loss. If my house burns down, the loss I have sustained is not purely a "datum of nature", as the authors seem to suggest.[27] I have suffered a loss only because the legal system attributes the ownership of the house to me. Conversely, if I part with $1,000, the law will not consider it a loss if I have done so for the purpose of discharging a debt. It seems unnecessary to amplify the analysis, though, it might admittedly be more difficult to apply it to bodily injury; suffice it to say that the presence of a normative element should not be regarded as a factor which disqualifies a prejudicial consequence from being regarded as loss in the legal sense: many quite ordinary types of loss would be affected.

It may have been their unfortunate and fallacious starting point which led the authors to assert further that a promisee's reliance interest has a better claim to judicial protection than has his expectation interest.[28] The first weakness of this argument is that it is based upon a judgment so sweeping that it is bound to be inappropriate to many, perhaps unexpected, cases. Further, reliance loss as the authors have themselves defined it, embraces instances of lost expectancies subject to precisely the

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24 Note 17 *supra,* 52.
25 *Id.,* 59 *et seq.,*
26 *Id.,* 52 *et seq.*
27 *Id.,* 53.
28 *Id.,* 56 *et seq.*

same objection which the authors raise against the primary expectation interest. They point out that "losses involved in foregoing the opportunity to enter other contracts"[29] should be treated as part of the reliance interest. Whilst this analysis is again impeccable in itself, such lost opportunities are no easier to qualify as losses than is the principal expectation interest (such alternate contractual benefits are things the promisee has never had).

Faced with what they concede to be the usual judicial practice of protecting the expectation interest, the authors set out on a search for a tenable rationale for that practice, but their bias against the expectation interest persists throughout the search. The "psychological" approach (based upon the disappointed promisee's sense of injury) and resort to the "will theory" of contract (agreement seen as a kind of private law for the parties)[30] are rightly dismissed as yielding no genuinely useful arguments. The more plausible "economic or institutional" explanation (expectation of future values equals present values for purposes of trade and is thus to be equated with present property deserving of protection) is also considered inadequate because it represents merely the economic effect of legal protection and not the reason for it.[31] This leaves the authors with two rationales both of which they call "juristic" (seeking a justification "in some policy consciously pursued by courts and other lawmakers").[32]

The first of these holds that the courts are protecting the expectation interest not for its own sake but merely as a way of either deterring promisors from causing reliance loss or, if reliance loss has occurred, of providing a convenient measure of its extent. Reliance interest is said to be much harder to quantify (a difficulty which is particularly acute in relation to lost opportunities to enter into other contracts which are seen as part of the reliance interest) and is thought to be adequately vindicated if compensation for the lost expectation is awarded.

The second "juristic" explanation advanced by Fuller and Perdue looks to the effect of judicial awards on the economy as a whole. They suggest that judicial protection of the expectation interest, with its deterrent effect upon promisors, will make contracts more reliable and will thus help to facilitate division of labour and commercial activity in general.[33]

These two rationales have a very strange feature in common: if accepted, they would justify protection of the expectation interest without the need to attribute the slightest intrinsic merit to this interest as it vests in individual promisees. One suspects that the authors' bias against that interest was based upon a view of the typical contract which saw it as

29 *Id.*, 60.
30 *Id.*, 57 *et seq.*
31 *Id.*, 59 *et seq.*
32 *Id.*, 60.
33 *Id.*, 60 *et seq.*

involving a winner (*e.g.* a buyer who has bought below market value) and a loser (the seller in the same example), and upon a reluctance to side with the winner (only the winner in such a case would be entitled to substantial expectation damages if the other side were to fail to perform). Such a view might have been reinforced by a dislike of those who seek to gain from speculative contracts. However understandable such sentiments might be, they would be in conflict with the age-old judicial approach which is simply that contracts should be kept, an approach which could hardly have developed if the expectation interest had been perceived as a thing without intrinsic merit.

The traditional judicial view seems to be that the typical contract is mutually advantageous and that contracting parties are entitled to incorporate the freely negotiated co-operative contractual commitment of others into their own private or business planning as an essential element. Such a view implies a much stronger rationale for the protection of the expectation interest than those stated by Fuller and Perdue. That rationale, based simply upon the position of the contracting parties, might be stated as follows:

> One purpose of a contractual damages award is to place the party faced with a wrongful denial of the promised benefit of the contractual performance in the position of being able to acquire, without any financial sacrifice of his own, as perfect as possible a substitute for the lost performance.

Such a formula recognizes the legitimacy of the promisee's plan, of which the broken contract was a part, and assumes that he will want to continue with it. That seems, on the whole, more realistic than the assumption that he will want to return to square one, which seems to be implicit in sole emphasis upon the reliance interest.

One wonders whether the emphasis placed by Fuller and Perdue upon the reliance interest and their attempt to devalue the expectation interest might, at least in part, be responsible for the fact that a false trail was created and followed in American legal-historical scholarship. Horwitz concluded, from certain early English and American cases, that there was a time in the history of contract law when the courts awarded damages only for reliance losses and when the expectation interest enjoyed no judicial protection at all.[34] In his thorough and persuasive response, Simpson has shown this part of the 'Horwitz Thesis' to be mistaken.[35]

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34 Horwitz, "The Historical Foundations of Modern Contract Law" (1974) 87 *Harv LR* 917.
35 Simpson, "The Horwitz Thesis and the History of Contracts" (1979) 46 *U Chic LR* 533, 547-61.

IV. THE SUBSTITUTION PRINCIPLE

The case law of all common law countries is replete with examples of the predominance of the expectation interest. Suffice it to mention just a few random instances. The most familiar of these is the rule that the buyer's compensation for the seller's failure to deliver is a sum equal to the price at which equivalent goods could have been purchased in the market, less, of course, the price stipulated in the contract.[36] An employer whose employee has left him without giving the requisite notice is entitled to the expense involved in hiring another person for the job.[37] Where a moneylender, in breach of contract, fails to make available a loan, the prospective borrower may recover such additional costs as are unavoidably involved in obtaining a substitute loan.[38]

The preference of the courts for the substitution approach is unmistakable; they will use it even where the plaintiff is required to make significant adjustments. This is borne out by *Commissioner for Railways* v. *Dangar*.[39] The defendant Commissioner had entered into a covenant to "use his best endeavours" to dedicate a strip of his own land (adjacent to the plaintiff's land) as a public road, an undertaking which Herron J. in the circumstances of the case interpreted as implying an obligation to construct the road. The defendant failed to carry out this undertaking and the plaintiff sued for damages. Had it been built, the road would have enhanced the value of the plaintiff's land. Rather than base his damages award on the difference between such enhanced value and the actual value of the land, Herron J. awarded the plaintiff the cost of constructing a substitute road on the plaintiff's own land. The learned judge based his award on the finding that the sacrifice of a strip of his own land would not have been unreasonable and that the remainder of the plaintiff's land would still have been considerably enhanced in value. The case shows very clearly the preference the courts feel for the substitution principle, provided that substitution is reasonably practicable.

There are cases in which a substitute is not obtainable or is inappropriate, and in these the value of the lost performance is measured in some other way, if necessary by use of a broad discretion.[40] A fitting example is the leading English case, *Chaplin* v. *Hicks*,[41] which has been applied frequently in Australia. The defendant, a theatrical manager,

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36 R.B.Vermeesh and K.E.Lindgren, *Business Law of Australia* (5th ed. 1987), 716.

37 *Outtrim, Howitt etc. Coal Co.* v. *Gregory* (1903) 9 ALR 52, 55 *per* Madden C.J., 57 *per* Hood J.

38 *Woolcott* v. *Mitchell and Watson* (1889) 10 ALT 187; *Head* v. *Kelk* [1963] SR (NSW) 1363; see also *The Manchester & Oldham Bank Ltd* v. *W.A. Cook & Co.* (1884) 49 LTR 674.

39 (1943) 15 LGR (NSW) 101.

40 *Cf. Chaplin* v. *Hicks* [1911] 2 KB 786 (hereinafter *Chaplin* v. *Hicks)*; *Howe* v. *Teefy* (1927) 27 SR (NSW) 301.

41 *Ibid.*

organised a beauty competition with the object of employing the twelve girls whom he considered the most beautiful. The plaintiff, though a "finalist", was denied the final interview and thus lost her chance of selection, a chance which the defendant had contractually undertaken to afford her. The jury assessed the damages at £100 and the Court of Appeal refused to interfere with this verdict. There was, of course, no question of substitution or of selling the chance; nor could the defendant have reasonably been expected to pay for the organising of another competition. As Vaughan Williams L.J. stated:

> [i]t is true that no market can be said to exist. None of the fifty competitors could have gone into the market and sold her right; her right was a personal right and incapable of transfer.[42]

Fletcher Moulton L.J. pointed out that little guidance could be given in an exceptional case of this kind:

> [w]here by contract a man has a right to belong to a limited class of competitors, he is possessed of something of value, and it is the duty of the jury to estimate the pecuniary value of that advantage if it is taken from him ... the measure of damages must be left to the good sense of the jury.[43]

In cases involving opportunities or chances lost because of the promisor's breach, the amount payable is not always fixed in as free-wheeling a fashion as was done in *Chaplin* v. *Hicks*.[44] Where the promisee has incurred preparatory expenses, whether in performance of his contractual obligations or otherwise, these may give some indication of the value which he placed upon the chance of which he has been wrongfully deprived, and may yield an acceptable measure for assessing the extent of his loss. An early Australian case in which this approach was used is *Aldwell* v. *Bundy*.[45] The defendants refused to hold a boat race which they had advertised and for which the plaintiffs had nominated and trained. The plaintiffs recovered what they had expended in preparing for the race during the period from their nomination to the defendant's breach. Whether expenses incurred during the period between the first advertisement and nomination were also recoverable was the subject of separate argument. Stow J. was willing to assume (although he entertained some doubts on this point) that no contractual relations of any kind existed during this period, but nevertheless allowed these expenses as damages. The learned judge stated that the loss occasioned by the breach was the loss of the chance of winning £150 (the advertised first prize) or £25 (the second prize). He then conceded that it was very difficult to estimate the value of this chance, pointed out that the plaintiffs had not been extravagant or unreasonable in incurring the expenses and concluded:

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42 *Id.*, 793.
43 *Id.*, 795 *et seq.*
44 *Ibid.*
45 (1876) 10 SALR 118; the decision was affirmed by the Local Court of Appeals - see (1876) 10 SALR 248.

> [i]t therefore seems that the only means of arriving at a conclusion as to the plaintiff's loss is to enquire as to the expense to which they were reasonably put in getting the crew into condition, and whether the expense was incurred before the nomination, or even before the advertisement, if by means of that expense they had got their crew into proper trim ... it seems consistently with the principles of common justice and law that for that loss they should be compensated.[46]

Stow J. was careful to stress that it should be open to the defendants in cases of this kind to show that there was no real chance of winning or that the plaintiffs had incurred expenses unreasonably and that, in such a case, preparatory expenses could not, or could only be partially, recovered.

The total amount recovered in this case exceeded two thirds of the promised first prize. It seems that the measure of damages applied led to a rather high valuation of the chance to win. Although Stow J. did not advert to the matter, the most appropriate explanation would be that the plaintiffs were compensated not only for the loss of the chance of winning money, but also for being wrongfully deprived of the pleasure and satisfaction of competing in the race which the defendant had undertaken to provide. *Aldwell* v. *Bundy*[47] seems to be a case of some importance; not only was it decided long before *Chaplin* v. *Hicks*,[48] it also anticipated well known cases such as *McRae* v. *The Commonwealth Disposals Commission*[49] and *Anglia Television Ltd* v. *Reed*[50] by many decades.

V. CONSEQUENTIAL LOSS

Consequential loss is a well-established category in our contract law. As explained earlier,[51] the promisor's failure to perform often has detrimental consequences for the promisee over and above the mere loss of the promised benefit. The rule in *Hadley* v. *Baxendale*[52] is primarily concerned with such consequential loss. The immediate loss of the promised benefit may be too speculative for definite measurement and assessment,[53] but it can never be too remote and can therefore not be subject to the rule in *Hadley* v. *Baxendale.*

It is a puzzling feature of Fuller and Perdue's article that consequential loss does not appear as a separate category. It is such an important form of loss and is so frequently considered by courts that the authors are not likely to have simply overlooked it. The explanation for its surprising absence from the purportedly comprehensive scheme of the article is that they considered it could and should be accommodated under the three

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46 *Id.*, 133.
47 *Ibid.*
48 *Chaplin* v. *Hicks* note 40, *supra.*
49 (1951) 84 CLR 377.
50 [1972] 1 QB 60.
51 Note 11 *supra.*
52 Note 14 *supra.*
53 *Cf. McRae* v. *The Commonwealth Disposals Commission* note 49 *supra.*

categories which they propose. They mention a particularly striking instance of consequential loss, *viz.* the case of a farmer who buys a cow warranted to be free from disease, which, because it is in fact diseased, contaminates the purchaser's whole herd.[54] According to their analysis, the loss of the herd may be regarded as either expectation or reliance loss:

> [s]o far as the item of direct loss is concerned (the contamination of the herd) it is not possible to draw a distinction between the reliance and the expectation interest. This loss would not have occurred either if the defendant had not broken his contract, or if the plaintiff had not entered and relied on the contract.[55]

It is submitted with respect that the authors' analysis is insufficiently differentiated. In the latest edition of his textbook, Treitel voiced the view that consequential loss "does not fit easily" into Fuller and Perdue's categories.[56] In a more recent work[57] he stated more definitely and with reference to the 'infected cow' example that such loss should be regarded as neither expectation nor reliance loss. This criticism seems incontrovertible. It would have been helpful if Fuller and Perdue had narrowed their definitions of expectation loss (confining it to the loss of promised benefits) and of reliance loss (confining it to 'investments' in the contractual venture which the promisee has deliberately made), and had added a fourth interest to their trichotomy: consequential loss, or, to remain within their conceptual scheme: 'the consequential compensation interest'.

VI. COVENANTED AND UNCOVENANTED BENEFITS

As defined by Fuller and Perdue, the expectation interest embraces two types of benefit: the benefit of the promised performance (the 'covenanted benefit'), and other, more remote benefits, such as potential resale profits, which the promisee might have been hoping to reap, but which the promisor had in no way promised to provide (uncovenanted benefits). The loss of uncovenanted benefits always represents consequential loss and is thus subject to a remoteness test. It must be carefully distinguished from the loss of covenanted benefits which is immune from any remoteness limitations. Australian courts have in fact observed this distinction quite scrupulously: success or failure of the plaintiff's case has not infrequently been made to depend upon the question whether a particular lost benefit fell into one or the other category. The answer invariably depends upon the construction of the contract.

Probably the most important relevant Australian case is *Fink* v. *Fink*.[58]

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54 Note 17 *supra*, 75.
55 *Ibid.*
56 Note 22 *supra*, 710.
57 Note 1 *supra*, 87.
58 (1946) 74 CLR 127.

A wife, estranged from her husband, sued him for damages for breach of an agreement that he would, for a period of one year, allow her to live in the matrimonial home, maintain her and refrain from initiating divorce proceedings. It was understood that he would, during this period, decide whether to forgive her. Before the year had elapsed, the defendant evicted the plaintiff and initiated divorce proceedings. The plaintiff sought to recover, inter alia, damages for the loss of the chance of being reconciled with the defendant and again living with him as his wife. She relied on two well-settled and often-repeated propositions: (1) that loss of a chance of gain, occasioned by breach of contract, may be a legitimate head of damage, and (2) that the task of assessing the plaintiff's damage in monetary terms must be performed, however difficult it may prove to be.[59] The defendant opposed the claim by relying upon the distinction highlighted above: if, to provide the plaintiff with a chance of reconciliation had been what the defendant had promised, the claim might have been justified on the basis of such cases as *Chaplin* v. *Hicks*. However, the facts of *Fink* were different: "The so-called opportunities of which the plaintiff complains that she has been deprived are not the subject of any promise to be found in the agreement."[60] Only two of the judges of the High Court (Latham C.J. and Williams J.) considered the plaintiff's claim under this head of damage to be well-founded. They conceded that the chance of reconciliation depended simply upon the defendant's volition and might therefore not be of much value; nevertheless,

> [t]hough the damages award might not be large, the loss of this opportunity, which the defendant contracted to provide, is, in our opinion, a matter for which damages can be given if a breach of the contract is proved.[61]

Neither Starke J. nor Dixon and McTiernan JJ. were able to detect any express or implied undertaking by the defendant to provide the plaintiff with the chance of reconciliation. Starke J. stated:

> [t]he purpose of the agreement is not to give the appellant an opportunity of reconciliation ... But to enable the respondent to consider whether he would or would not forgive her.[62]

Let it be conceded that according to the joint judgment of Dixon and McTiernan JJ., the chance of reconciliation was too remote and speculative on any basis to be a legitimate head of damage.[63] Nevertheless, the case shows with quite sufficient clarity that a plaintiff's case is made much easier if he or she can prove that the loss sustained is not consequential, but represents loss of a benefit which the defendant has undertaken to provide.

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59 Both propositions were endorsed by the Court of Appeal in *Chaplin* v. *Hicks* note 40 *supra* and may be regarded as settled law in England and Australia - see also *Howe* v. *Teefy* note 40 *supra*.

60 Note 58 *supra*, 132.

61 *Id.*, 135.

62 *Id.*, 138.

63 See particularly observations *id.*, 143.

Fink v. *Fink*[64] should be contrasted with *Chaplin* v. *Hicks* which has already been related.[65] The essence of *Chaplin* v. *Hicks* was summed up by the High Court in *McRae* v. *The Commonwealth Disposals Commission*:[66] "The broken promise itself in *Chaplin* v. *Hicks* [1911] 2 KB 786 was, in effect, 'to give the plaintiff a chance'."[67]

The hope to use the contract for profit is the basis of many contracts; any wholesaler or retailer buys his wares in the expectation that he will make a profit when he resells them to his customers. When the supplier fails to deliver in breach of contract, potential resale profits will be lost. The supplier may be liable to compensate for such loss of profit, but it is an item of consequential damage and may therefore be regarded as too remote. However, there are exceptional cases in which the courts have held that the defendant had undertaken not only to deliver the goods but also to provide the associated chance of profit to the plaintiff. Though ambiguous, the decision of the House of Lords in *Hall* v. *Pim*[68] is best explained in this way. An unambiguous Australian example is *Howe* v. *Teefy*.[69] The plaintiff, a trainer of racehorses, leased a racing gelding from the defendant for 3 years, the understanding of the parties being that he was to have the horse "for a racing proposition". After a few months the defendant took the horse back in breach of the contract and the plaintiff sought to recover, inter alia, compensation for the money he would have made through placing bets upon the horse and through supplying information concerning the horse to prospective punters. A substantial damages award having been made by a jury, the question before the Full Court of the Supreme Court of New South Wales was whether the loss of profit was too remote and too difficult to assess. The Court answered these questions in the negative. Their Honours considered the case to be even stronger than *Chaplin* v. *Hicks*. As Street C.J. stated:

> [i]n *Chaplin* v. *Hicks* [1911] 2 KB 786 the plaintiff had paid nothing to become a competitor, but she recovered damages for the breach of contract complained of. In this case the plaintiff agreed to pay a substantial price under this contract for the right to the advantages to be got from training and racing the horse, and he was afterwards deprived of his right by the defendant's breach of contract.[70]

On the question of assessment of the monetary value of the plaintiff's loss, Street C.J. stated:

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64 Note 58 *supra*.
65 Note 41 *supra*.
66 Note 49 *supra*.
67 *Id.*, 412.
68 [1927] All ER Rep 227.
69 *Howe* v. *Teefy* note 40 *supra*.
70 *Id.*, 307.

> [t]he calculation which [the jury] had to make was not how much he would probably have made in the shape of profit ... but how much his chance of making that profit, by having the use of the horse, was worth in money.[71]

It is obvious from the judgments, in particular from the application of *Chaplin* v. *Hicks,* that the chance to make money through betting and supplying of information was regarded by the court as having been part and parcel of the defendant's contractual undertaking and that this fact placed the loss of the chance in a special, favoured category for purposes of recovery.

Contracts of service will not infrequently imply an undertaking to ensure that the promisee is given the benefit of some chance or opportunity. In *Coombs* v. *Brown*[72] the defendant failed, in breach of an undertaking, to attend an auction and bid up to £17 for a rumbler (worth £30). The rumbler was sold at the auction for £15 and 10s. Mr Justice Angas Parsons awarded nominal damages only. It is submitted, with respect, that this decision is in direct conflict with *Chaplin* v. *Hicks,* which appears to have been overlooked. The plaintiff had a contractual right to the chance of purchasing the rumbler for £17 or less and the defendant's breach had deprived him of that chance. The chance was a covenanted benefit and remoteness considerations were thus irrelevant to the plaintiff's case. Substantial damages can only be denied in such a case where the chance is demonstrably worthless,[73] or where it is so speculative as to be as good as worthless.[74]

There are bound to be items of loss, other than lost opportunities or chances, which raise analogous issues. Cases which illustrate this are those in which plaintiffs have put forward mental anguish, annoyance and disappointment of mind as items of loss. Awarding damages for such items is incompatible with older, well-known authorities. In *Hobbs* v. *London & South Western Railway Co.*[75] Mellor J. stated:

> for mere inconvenience, such as annoyance and loss of temper, or vexation, or for being disappointed in a particular thing which you have set your mind upon, without real physical inconvenience resulting, you cannot recover damages.[76]

In *Athens-McDonald Travel Agency* v. *Kazis*[77] Zelling J. felt that these limitations were unduly restrictive, and in a closely similar case, *Jarvis* v. *Swans Tours Ltd*[78] Lord Denning M.R. allowed himself the

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71 *Ibid.*
72 [1940] SASR 211.
73 See *Watt* v. *Duggan and Connell* [1913] QWN 48.
74 *Fink* v. *Fink* note 58 *supra.*
75 (1875) LR 10 QB 111.
76 *Id.*, 122.
77 Note 6 *supra,* 270.
78 [1973] 1 All ER 71, 74.

characteristically generous observation that they were out of date. Annoyance, disappointment and even mental anguish are very frequently experienced by those at the receiving end of breach of contract. Where such sensations are merely consequential upon the breach of an ordinary commercial contract, damages can normally not be recovered for them.[79] However, when the promisor has undertaken to provide the promisee with pleasurable experiences (such as a relaxing holiday) or to safeguard the promisee from annoyance or other unpleasant sensations, then one is faced with a much more meritorious case. Where unpleasant sensations constitute the direct loss of a promised benefit, compensation will be awarded.

An Australian case in point is *Silberman* v. *Silberman.*[80] A wife sued her husband for breach of covenant not to molest, and substantial damages were awarded (the breach being found to consist of the making of defamatory statements), even though the plaintiff had produced no evidence of pecuniary loss or special damage. The defendant attacked the verdict on the familiar ground that nominal damages only can be recovered in the absence of proof of some specific loss. The Full Court of the Supreme Court of New South Wales rejected the submission. Cullen C.J. stated:

> [c]ounsel for the defendant relied on the ordinary rule in regard to damages arising from a breach of contract that unless there is evidence of something more than a mere breach of the contract nominal damages only can be recovered. It seems to me that before we can arrive at that position we must look at the nature of the contract and see what its object was, and what it bound the contracting parties to do or to abstain from doing.[81]

To illustrate the principle applicable to the case, the learned Chief Justice referred to a bandmaster who undertakes not to play in front of a householder's house and then breaks his promise:

> [i]n my opinion the mere breach of such a contract brings about the very consequence contemplated by the parties ... if it is proved that bare annoyance has been inflicted it is not necessary to go further and show that some precuniary loss has been suffered through that annoyance.[82]

Silberman v. *Silberman*[83] bears out the analysis here proposed. It provides a satisfactory rationale for the 'holiday cases' in which substantial damages for disappointment were awarded because enjoyment had been promised. It lends added support to one of the main submissions of this paper, *viz.* that the distinction between promised benefits and benefits which are merely expected as consequential upon the promised performance deserves a place of considerable prominence in the law of contract damages.

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79 *Falco* v. *James McEwen & Co. Pty Ltd* [1977] VR 447.
80 (1910) 10 SR (NSW) 554.
81 *Id.*, 556.
82 *Id.*, 557, 559.
83 *Ibid.*

VII. CONCLUSION

This paper has been concerned almost exclusively with failure to perform and with those forms of material breach which allow the promisee to treat the breach as one involving total loss of bargain. There are other forms of breach, particular non-material ones, to which the analysis proposed here may not be appropriate. Such a qualification should also be applied to Fuller and Perdue's article.

The great significance of Fuller and Perdue's contribution should not be doubted. This paper is an attempt to identify and remedy three shortcomings in their scheme. Although it is written from an Australian perspective and relies upon Australian authorities, there seems to be no reason why the following findings should be less appropriate to other common law jurisdictions:

(1) Fuller and Perdue's attempt to subordinate the expectation interest to the reliance interest, as manifest in their selection of unnecessarily weak rationales for its protection, is unjustified and should be corrected, partly by recognizing the stronger rationale which has been identified. This submission involves matters of economic and, perhaps, political judgment. It may be considered potentially controversial.

(2) The absence of consequential damage from Fuller and Perdue's scheme, as an element on a par with the three interests which they have identified, appears to be the result of insufficiently thorough analysis. Had it been pointed out to the authors, they would have had to concede it.

(3) The authors' failure to distinguish covenanted from uncovenanted benefits within the expectation interest, flows directly from the difficulty just mentioned. It is submitted that this distinction should take its just place as an important analytical tool in the practical resolution of damages issues.