

THE DETRIMENT OF THE BARGAIN: HOW THE LIMITING PRINCIPLE AND PRECLUSION OF PRE- CONTRACTUAL EXPENDITURES PLACE UNDUE RISK ON A NON-BREACHING PARTY

I. INTRODUCTION

If scholars conceive of contract law as a tool for assigning default risks and burdens, which the contracting parties have a freedom to alter through prior agreement, then the award of damages arising out of breach has everything to do with encouraging or discouraging future behaviors of the defendant-promisor and plaintiff-promisee. Not every corner of contract law ought to deal in economic carrots, however. There should be room left instead for considerations of corrective justice, so that a court (whose duty is to resolve real disputes between real litigants) may make a promisee whole through the remedy handed down. Such an adjustment would make a “pure” reliance remedy more attractive as an alternative measure of the harm done to the promisee.

Contract law delicately balances issues related to the origin and obligation of the agreement, its performance, and its termination, even as contract scholars aspire to bring all three of these aspects under one overarching theory. Two of the more contentious issues in contract law are (1) whether to enforce a particular agreement, and (2) how to adequately remedy the promisee’s injury without overcompensation. Part II of this note will briefly summarize and compare how the law approaches these two issues in contemporary and historical contexts. Part III will focus this inquiry specifically on reliance in terms of enforcement and remedy. Part IV proposes a few reforms to the reliance remedy in light of this discussion, especially as it relates to the limiting principle and the preclusion of pre-contractual expenditures. Part V provides concluding thoughts.

II. BACKGROUND

A. *Distinguishing Basis, Interest, and Remedy*

Any foray into the complex and hotly-contested realm of contract remedies demands careful examination of the terms in order to facilitate the greatest discovery at the smallest possible risk of confusion.¹ Thus,

¹ As Professor Frost suggests, “There is considerable pedagogical value to starting contract problems by focusing on the stakes.” Christopher W. Frost, *Reconsidering the Reliance Interest*, 44 ST. LOUIS U. L.J. 1361, 1362 (2000). Strangely enough, discussion of contract remedies was not prominent in law schools until the Realists of the early 1930s brought a renewed focus upon them. See Todd D. Rakoff, *Fuller and Purdue’s The Reliance Interest as a Work of Legal Scholarship*, 1991 WIS. L. REV. 203, 211. Given the

to cavalierly advance an argument with respect to the much-maligned reliance remedy for breach of contract without drawing a distinction between reliance-based obligation, the reliance interest, and the reliance remedy would be to invite chaos at every corner.²

“Reliance” across all three connotations has a degree of consistency to the extent that the term lends itself to this broad application: generally, reliance refers to the promisee’s actions that are justified by a promise made by another,³ whether the promisee acts in direct response in order to receive the benefit of a performance from the other party,⁴ or acts indirectly by changing position in anticipation of gratuitous performance from that other party.⁵

The law may, and frequently does, recognize a promisee’s reasonable reliance on a promise as the *reason* for imposing liability against a promisor who has failed to keep that promise, thereby making reliance the basis for a contractual obligation.⁶ Two other possible bases of obligation—formalism and bargained-for consent⁷—have historically been recognized, with the influence of all three bases felt in modern contract law.⁸

Given a valid and enforceable contract according to any of these three recognized bases, the law may seek to satisfy a promisee’s reliance *interest* (as opposed to satisfying the expectation interest or restitution interest) in its attempt to place the promisee in as good a position as he

foundational position of remedies in contemporary study of contracts, confusion regarding their implementation can easily spill over into other areas of contract law.

² See, e.g., discussion of *Farash v. Sykes Datatronics, Inc.*, 452 N.E.2d 1245 (N.Y. 1983), *infra* Part IV.F.

³ ERIC MILLS HOLMES, 3 CORBIN ON CONTRACTS § 8.4, at 12-13 (Joseph M. Perillo ed., rev. ed. 1996).

⁴ *Id.* § 8.5, at 13-15.

⁵ *Id.* § 8.6, at 15.

⁶ Oldham argues that around 1600 the whole of contract law was swallowed by tort through its basis in reliance. James Oldham, *Reinterpretations of 18th-Century English Contract Theory: The View From Lord Mansfield’s Trial Notes*, 76 GEO. L.J. 1949, 1953 (1988); see also historical discussion *infra* Part II.C. Today, promissory estoppel is the doctrine through which contractual obligation is based upon detrimental reliance. See RESTATEMENT (SECOND) OF CONTRACTS § 90 (1981); see also discussion *infra* Part III.C.

⁷ See historical discussion *infra* Part II.C.

⁸ Promissory estoppel allows courts to recognize a contract based on the promisee’s reliance. See RESTATEMENT (SECOND) OF CONTRACTS § 90 (1981); see also discussion *infra* Part III.C. The Statute of Frauds, adopted in most of the United States, requires parties in certain contracts to put the central aspects of the agreement in writing. 9 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 21:4, at 181-92 (4th ed. 1999) [hereinafter 9 WILLISTON]. Of course, the dominant theory today is bargained-for consent. 1 STEWART MACAULAY ET AL., CONTRACTS: LAW IN ACTION 35 (1995). See, e.g., 24 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 64:2, at 21-22 (4th ed. 1992) [hereinafter 24 WILLISTON]; U.C.C. § 2-204(1) (2002). See historical discussion *infra* Part II.C.

occupied prior to the formation of the contract.⁹ Causation problems notwithstanding,¹⁰ applying the reliance interest even where a contractual obligation is based on a bargained-for consent does not require any glaring intellectual dishonesty. Fuller and Purdue, in their pioneering article *The Reliance Interest*, frame the reliance interest in terms of bargain-based obligation¹¹ and “non-bargain’ promises.”¹²

Finally, a court may use a promisee’s reliance damages as a measure of the appropriate *remedy* for breach, although a contract remedy is no more closely wed to an interest than an interest is to a basis for obligation. For instance, Fuller and Purdue expound an expectation remedy as the best approximation of the reliance interest;¹³ courts enforcing contracts based solely on detrimental reliance (promissory estoppel) have awarded expectation damages;¹⁴ and, even though the reliance interest has been thought to include compensation for lost opportunities,¹⁵ “[c]ourts use the term ‘reliance’ to refer to those out of pocket losses that were incurred as a direct result of the promise.”¹⁶

⁹ This is reliance as defined by Fuller and Purdue. L.L. Fuller & William R. Purdue, Jr., *The Reliance Interest in Contract Damages*, 46 YALE L.J. 52, 54 (1936). See discussion on the pitfalls attendant with defining the reliance interest, *infra* Part IV.A.

¹⁰ See discussion *infra* Part IV.D.

¹¹ Fuller & Purdue, *supra* note 9, at 65.

[T]he policy in favor of facilitating reliance can scarcely be extended to all promises indiscriminately. Any such policy must presuppose that reliance in the particular situation will normally have some general utility. Where we are dealing with ‘exchanges’ or ‘bargains’ it is easy to discern this utility since such transactions form the very mechanism by which production is organized in a capitalistic society.

Id.

¹² *Id.*

¹³ This is to the extent that the reliance interest would include lost opportunities. See W. David Slawson, *The Role of Reliance in Contract Damages*, 76 CORNELL L. REV. 197, 220 (1990) (citing L.L. Fuller & William R. Purdue, Jr., *The Reliance Interest in Contract Damages*: 2, 46 YALE L.J. 373, 373-76 (1936)).

¹⁴ See Christopher T. Wonnell, *Expectation, Reliance, and the Two Contractual Wrongs*, 38 SAN DIEGO L. REV. 53, 118 (2001) (citing Randy E. Barnett & Mary E. Becker, *Beyond Reliance: Promissory Estoppel, Contract Formalities, and Misrepresentation*, 15 HOFSTRA L. REV. 443 (1987)).

¹⁵ See, e.g., Michael B. Kelly, *The Phantom Reliance Interest in Contract Damages*, 1992 WIS. L. REV. 1755, 1766; Rakoff, *supra* note 1, at 221. However, Fuller and Purdue chose not to address the question of whether lost opportunity was properly compensable in damages. Fuller & Purdue, *supra* note 9, at 55.

¹⁶ Frost, *supra* note 1, at 1375.

B. Morality, Efficiency, and Risk Allocation

Added to basis, interest, and remedy, contract law may have its normative justification in a number of public policies. That is, the very reason for courts to *ever* enforce private agreements can arise from the morality of keeping promises, the desire to alleviate harm resulting from broken promises, the social stability fostered by upholding promises, or even the economic efficiency of enforcing consensual bargains. As is evident, these norms often will approximate or suggest a particular basis of obligation, protectible interest,¹⁷ or remedy,¹⁸ yet they are compatible with a variety of them.¹⁹

Historically, the common law has most prominently featured two normative justifications: moral obligation and economic efficiency.²⁰ While not necessarily opposed,²¹ these norms can at times come into conflict within discussions of whether to award punitive damages²² or attorney's fees,²³ or whether to award expectation damages as opposed to out-of-pocket expenditures.²⁴

Contract breach, when described as a sin or a wrong, does not rise to the level of moral transgression associated with lying, for "a promise puts the moral charge on a *potential* act—the wrong is done later, when the promise is not kept—while a lie is a wrong committed at the time of its utterance."²⁵ A survey of the Ten Commandments will reveal the

¹⁷ "An interest resembles a normative claim, but it is not identical to it." Rakoff, *supra* note 1, at 217.

¹⁸ "The invocations of benefit and reliance are attempts to explain the force of a promise in terms of two of its most usual effects, but the attempts fail because these effects depend on the prior assumption of the force of the commitment." Charles Fried, *Contract as Promise*, in FOUNDATIONS OF CONTRACT LAW 11 (Richard Craswell & Alan Schwartz eds., 1994).

¹⁹ Catholic jurists of the eleventh and twelfth centuries, along with Puritans of the seventeenth and eighteenth centuries, agreed upon the breaking of a promise as a sin. Harold J. Berman, *The Religious Sources of General Contract Law: An Historical Perspective*, 4 J.L. & RELIGION 103, 109, 113, 115 (1986). So, from a common premise, they crafted very different systems for enforcement. *See id.*

²⁰ *See* historical discussion *infra* Part II.C.

²¹ "[I]n many cases the alleged necessary connection between efficiency and amorality is mythical." Peter Linzer, *On the Amorality of Contract Remedies—Efficiency, Equity, and the Second Restatement*, 81 COLUM. L. REV. 111, 112 (1981).

²² *See* ARTHUR LINTON CORBIN, 11 CORBIN ON CONTRACTS § 1077, at 380 (Interim ed. 2002) [hereinafter 11 CORBIN].

²³ *See id.* § 1037, at 193-94.

²⁴ This is because a larger award will tend to deter breach, whereas a smaller one will reduce the incentive to keep a promise. Richard Craswell, *Against Fuller and Purdue*, 67 U. CHI. L. REV. 99, 108 (2000).

²⁵ Fried, *supra* note 18, at 9. *But see* discussion of causation between wrong and injury, *infra* Part IV.D.

explicit proscription against lying,²⁶ but a proscription against breaking promises has less emphatic Biblical support.²⁷

Breach in the context of the efficiency norm demands remedies designed to allocate cost burdens by default rules except where the parties contract to shift these burdens according to freedom of contract principles.²⁸ Remedies can therefore be tailored to create efficient outcomes because a promisor's willingness to breach will depend upon the court-imposed cost of that breach.²⁹ For example, expectancy damages will encourage a breach to be "efficient," so that the promisor will not breach unless that action benefits both parties.³⁰ By contrast, reliance damages will allow breach where the parties have yet to perform and encourage it where the promisor stands to profit from the breach beyond the expense incurred by the promisee.³¹ Alternatively, the default remedies can cause the parties to bargain for a different allocation of risk—including the risk of losing a suit for damages through the assigning of attorney's fees to be paid to the successful party³²—with one exception being that a liquidated (contractually-determined) damages clause cannot serve as a penalty against the breaching party.³³

Notwithstanding the particular emphasis on allocation of risk within the economic efficiency norm, the determination of what burden falls upon either party has equal relevance where moral obligation

²⁶ *Deuteronomy* 5:20.

²⁷ See, e.g., *Jeremiah* 11:1-8. Contractual obligation in the context of this passage was collective, entered into between the people of Israel and God. One New Testament Passage suggests that even individual oaths to God must be kept. See *Matthew* 5:33. "The Parable of the Workers in the Vineyard" treats a contract-like arrangement as its subject, though the message conveyed is that the master can do what he wants with his money. *Matthew* 20:1-15.

²⁸ "Under the bargain principle, bargains between capable and informed actors are enforced according to their terms." Melvin Aron Eisenberg, *Probability and Chance in Contract Law*, 45 *UCLA L. REV.* 1005, 1010 (1998). Compare this with Harold Berman's analysis of the moral theory of contract, where "every individual has a moral right to dispose of his property by means of making promises, and that in the interest of justice a promise should be legally enforced unless it offends reason or public policy." Berman, *supra* note 19, at 112.

²⁹ Linzer, *supra* note 21, at 114 ("[E]fficiency theory suggests that promisors who breach increase society's welfare if their benefit exceeds the losses of their promisees."). One might wonder, though, why courts of justice would ever put more stock in future incentives geared toward a breaching promisor than in retrospective (corrective) compensation for a relying promisee's injury.

³⁰ Mark Pettit, Jr., *Private Advantage and Public Power: Reexamining the Expectation and Reliance Interests in Contract Damages*, 38 *HASTINGS L.J.* 417, 431-32 (1987).

³¹ *Id.*

³² See 11 *CORBIN*, *supra* note 22, § 1037, at 193-94.

³³ See *id.* § 1077, at 381.

justifies the enforcement of contracts.³⁴ Indeed, an allocation process informed by social norms provides the starting point from which to derive all three of the concepts discussed above (basis, interest, and remedy).

The allocation process in contract law ought to have more logical consistency throughout. A court protecting the reliance interest should not attempt to place the promisee in a position as though the promise had been performed, but instead should attempt to place the promisee in the position the promisee occupied before the contract's formation.³⁵ Also, courts giving force to the mutual assent of the parties should not preclude outright an award of the pre-contractual expenditures of the promisee assented to by the promisor.³⁶ Moreover, a legal allocation process informed by efficiency norms should properly encourage *ex post* negotiation so that parties may adjust to changing conditions in ways that more fairly allocate noneconomic burdens, which courts have no desire or ability to measure.³⁷ A privately-bargained method of allocation, on the other hand, need not demonstrate any logical consistency—rather being itself a product of market forces—and better accounts for noneconomic factors.³⁸

Viewed more simply, a court acting in its capacity to allocate risk gives to one party at the expense of the other, so that it will enforce a promisee's right to recovery only up to a limit set according to how much pain the law is willing to inflict on a promisor; here, the American system seeks to restore a plaintiff to the *status quo*, no better or worse.³⁹ This Aristotelian notion of corrective justice has driven Anglo-American contract law from its beginnings.⁴⁰ While a court ought not to reflexively take those burdens that rightly belong to a promisee and shift them instead to the promisor, no absolute legal principle suggests that certain

³⁴ Again, the differences between the Puritan and Catholic systems are illustrative. Whereas under the canon law contracts were enforced only to the extent of their fairness, the strict-liability Puritans placed the entire burden of an unfair deal upon the breaching party. Berman, *supra* note 19, at 122; *see also* discussion *infra* Part II.C.

³⁵ *See* discussion *infra* Part IV.A.

³⁶ *See* discussion *infra* Part IV.E.

³⁷ *See* discussion of limitation principle, *infra* Part IV.C. As for the reluctance of courts to factor in noneconomic damages, this principle is as firmly rooted in contract law as the prohibition against awarding punitive damages or attorney fees. *See* 11 CORBIN, *supra* note 22, § 1077, at 380; *id.* § 1037, at 193-94.

³⁸ Stewart Macaulay, *The Reliance Interest and the World Outside the Law School's Doors*, 1991 WIS. L. REV. 247, 263.

³⁹ Larry A. DiMatteo, *The History of Natural Law Theory: Transforming Embedded Influences into a Fuller Understanding of Modern Contract Law*, 60 U. PITT. L. REV. 839, 844 (1999). "This remedy is not intended as a means of punishment or retaliation; rather, it is designed to compensate or return damaged parties to the status quo." *Id.*

⁴⁰ *Id.*

risks or burdens belonging to one party initially—or even prior to contracting—can never shift to the other party (or disappear altogether through excuse) between the formation and breach of a contract.⁴¹

C. Historical Trends in Contract Formation, Interest, and Remedy

To flesh out further how basis, interest, and remedy, along with their normative justifications, work together to define modern contract law, it helps to have at least a cursory review of broad historical trends in the Anglo-American system.⁴² The temptation, of course, is to begin with the several English Common Law writs and march onward into the nineteenth and twentieth centuries;⁴³ however, in avoiding this secularized approach, we may instead begin at the beginning.

According to Harold Berman, “Modern contract law originated in Europe in the late eleventh and early twelfth centuries,”⁴⁴ as part of a larger effort to create “consciously integrated systems of law . . . *first in the church and then in the various secular polities.*”⁴⁵ Contractual liability, to the canonists in the church, arose from a combination of the theory that to break a promise is a sin and the idea that society ought to protect the rights of a promisee.⁴⁶ Thus, the canonists “developed for the first time the general principle that an agreement as such—a *nudum pactum*—may give rise to a civil action.”⁴⁷ As a limit to liability, the obligation was enforced only to the extent that it was both “reasonable and equitable.”⁴⁸

These rules not only governed the ecclesiastical courts of the day, which had wide jurisdiction over clergy and laymen,⁴⁹ but also greatly

⁴¹ See discussion *infra* Part IV.E.

⁴² And, if a proper historical context plays so central a role in descriptive analysis, how much more so does it nurture the normative discussion to follow! As Harold Berman writes, “Both (the) attackers and defenders (of the prevailing nineteenth century theory of contract law) need to be aware . . . of its historical background, and especially of the religious sources from which it was derived and against which it reacted.” Berman, *supra* note 19, at 124.

⁴³ “[S]ome historians of English law have said that it ‘was not until the eighteenth century that a serious search for a general theory of contract was undertaken,’” but, replies Berman, “It can hardly be maintained that prior to the eighteenth century contractual liability was not considered to be based on a coherent set of principles, including the principle of the binding force of a bargained agreement expressing the intent of the parties.” Berman, *supra* note 19, at 118 (quoting T.F.T. PLUCKNETT, A CONCISE HISTORY OF THE COMMON LAW 652 (5th ed. 1956)).

⁴⁴ *Id.* at 106.

⁴⁵ *Id.* (emphasis added).

⁴⁶ *Id.* at 109.

⁴⁷ *Id.*

⁴⁸ *Id.* at 110.

⁴⁹ *Id.* at 113.

influenced the entire English law of contracts even beyond the time of the Protestant Reformation. As Berman explains:

Despite the significant changes in the law of contracts which took place in the sixteenth and early seventeenth centuries, in all the legal systems that prevailed in England, including the common law, the underlying presuppositions of contractual liability remained what they had been in the earlier period. Breach of promise was actionable, in the first instance, because—or if—it was a wrong, a tort, and in the second instance, because—or if—the promisee had a right to require its enforcement in view of its reasonable and equitable purpose.⁵⁰

Significantly, though, following the Puritan Revolution of the 1600s, three related changes took place. First, “the underlying liability shifted from breach of promise to breach of a bargain.”⁵¹ Second, “the emphasis on bargain was manifested in a new conception of consideration.”⁵² Finally, “the basis of liability shifted from fault to absolute obligation.”⁵³ These changes were carried through not by lawyers, but by theologians,⁵⁴ and were premised on the sovereignty of God, the total depravity of humanity, and the belief in a covenantal relationship between God and humans.⁵⁵ Modeling their theory of contract after this relationship, entered into voluntarily by the Creator and the created and absolutely binding on both sides, the Puritans felt that “each man was free to choose his act but was bound to the choice he made, regardless of the consequences.”⁵⁶

Contract formation, within law and equity, experienced the influence of three bases for obligation early on in the development of contract: formalism,⁵⁷ reliance,⁵⁸ and bargained-for consent.⁵⁹ First, the

⁵⁰ *Id.* at 114-15.

⁵¹ *Id.* at 116.

⁵² *Id.*

⁵³ *Id.* at 117.

⁵⁴ *Id.* at 119.

⁵⁵ *Id.*

⁵⁶ *Id.* at 122.

⁵⁷ This basis reigned alone prior to the canon law’s enforcement of a *nudum pactum*. See *supra* note 47 and accompanying text. It remains influential today in the Statute of Frauds. See Charles L. Knapp, *Rescuing Reliance: The Perils of Promissory Estoppel*, 49 HASTINGS L.J. 1191, 1202 (1998). However, the Statute acts differently than did the seal requirement. 9 WILLISTON, *supra* note 8, § 21:1, at 170. (“[T]he writing was not the particular formality which gave force to such [formal] contracts.”). One can view the modern law of contracts as consisting of both formal and informal obligations, with the limitation that formal requirements only determine the enforceability of certain contracts and not their validity. See *id.* Still, Williston suggests a cautionary function for the Statute in addition to its evidentiary function, which places it in closer proximity to the role played by sealed instruments. See *id.* § 21:1, at 172.

seal was at one time the only basis for contractual obligation—under the writ of covenant—giving medieval contract law a very formalistic shape.⁶⁰ Through the tort-related writ of assumpsit, however, formal requirements were relaxed,⁶¹ as benefit and detriment became potential bases for obligation, so that reliance became a reason for enforcement.⁶² Finally, despite disagreement as to whether consent-based obligation existed prior to 1800,⁶³ it is agreed that afterward “[a]ll contracts came to be seen as consensual, even wholly executed contracts, even those consisting of an immediate and simultaneous exchange . . . came to be perceived as depending on an agreement or an exchange of promises.”⁶⁴

Similarly, the three contract interests—expectancy, reliance, and restitution—were influential long before Fuller and Purdue gave them their present shape.⁶⁵ Specific performance, which satisfies a promisee’s

⁵⁸ Reliance-based obligation in the writ system is mostly associated with the Chancery and with the writ of assumpsit, where the wrong done was misfeasance rather than nonfeasance. Oldham, *supra* note 6, at 1956. Still, reliance can act as a basis for obligation in cases of nonfeasance, where the breaching party has refused any performance, just as in cases of misfeasance, where the breaching party performs but not in the way reasonably expected. In either situation, the promisee has taken action based on the promise in hopes that the promisor keeps the promise.

⁵⁹ *See id.* at 1952-53 (Likewise, bargained-for consent has its roots more in the nonfeasance, contract-related writ of covenant, but it has just as much to do with cases of misfeasance that were typically resolved under the writ of debt where the only performance left to render was the payment of money from the promisor to the promisee.).

⁶⁰ *Id.* at 1951. “Covenant, the writ bearing the closest resemblance to promissory obligations that strike the modern reader as contractual, was hampered by the requirement of a sealed instrument in all cases, and the limitation of its scope to actions for nonfeasance.” *Id.* at 1952.

⁶¹ The writ of assumpsit grew out of the tort-related writ of trespass. *See id.* at 1953-54; Randy E. Barnett, *The Death of Reliance*, 46 J. LEGAL EDUC. 518, 519 (1996) (citing GRANT GILMORE, *THE DEATH OF CONTRACT* (1974)).

⁶² Oldham, *supra* note 6, at 1958 (citing P.S. Atiyah, *THE RISE AND FALL OF FREEDOM OF CONTRACT* 419 (1979)).

⁶³ *See supra* note 43.

⁶⁴ Oldham, *supra* note 6, at 1958 (quoting P.S. ATIYAH, *THE RISE AND FALL OF FREEDOM OF CONTRACT* 419 (1979)).

⁶⁵ Contemporary treatment of the three is somewhat artificial, and even Fuller advocated their being treated as a continuum rather than distinct interests. Craswell, *supra* note 24, at 105 (citing Letter from Lon L. Fuller to Karl Llewellyn (Dec 8, 1939), *quoted in* ROBERT S. SUMMERS AND ROBERT A. HILLMAN, *CONTRACT AND RELATED OBLIGATION: THEORY, DOCTRINE, AND PRACTICE* 41 (West 3d ed. 1997)).

At times the reliance interest includes the notional value of lost opportunities, and thus approaches congruence with the expectation interest; at other times, it sheds this weight and becomes distinctly thinner. At times, the restitution interest is treated as merely a lesser-included-case of reliance, subject to the same theoretical treatment; while elsewhere the two appear to separate.

Rakoff, *supra* note 1, at 213 (citing L.L. Fuller & William R. Purdue, *The Reliance Interest in Contract Damages*, 46 YALE L.J. 52 (1936)).

expectation interest better than compensatory damages,⁶⁶ was present in ecclesiastical courts as early as the eleventh and twelfth centuries.⁶⁷ Aside from this exception, the reliance interest was the predominant measure of awards for contract actions until the bargained-for consent basis for contract obligation—which took hold by the nineteenth century⁶⁸—brought the expectancy measure into greater focus.⁶⁹ Finally, the restitution interest enjoyed protection from the Chancellor,⁷⁰ whose actions influenced the development of the common law writs.⁷¹ Thus, history also paints a picture of several interests in contract working complementarily under one system.

III. RELIANCE BASIS, INTEREST AND REMEDY IN MODERN CONTRACT LAW

A. *Fuller and Purdue's* The Reliance Interest

In their 1936 article *The Reliance Interest*, Lon Fuller and William Purdue described three interests that a promisee has in relation to a contract; this categorization serves, for good or ill, as the starting point for discussing remedies in many contracts classes today.⁷² The three interests are restitution, reliance, and expectancy,⁷³ though the authors make clear that these interests do not have equal claim to judicial intervention, with restitution providing the strongest claim and expectancy providing the weakest.⁷⁴

There is at least some confusion as to what the reliance interest entails due to some commentators' carelessness with language, in that some suggest it places the promisee in a position as though the contract

⁶⁶ Linzer, *supra* note 21, at 138 ("The general use of specific performance will produce truer economic efficiency than a system that counts the money cost of performance to the promisor but not the unquantifiable emotional and other costs of nonperformance to the promisee.").

⁶⁷ Berman, *supra* note 19, at 106-07, 109-10.

⁶⁸ 1 CONTRACTS: LAW IN ACTION, *supra* note 8, at 35.

⁶⁹ Louis E. Wolcher, *The Accommodation of Regret in Contract Remedies*, 73 IOWA L. REV. 797, 804 (1988).

⁷⁰ ARTHUR LINTON CORBIN, 12 CORBIN ON CONTRACTS § 1102, at 2 (Interim ed. 2002).

⁷¹ See, e.g., Oldham, *supra* note 6, at 1953 (citing J.H. BAKER, AN INTRODUCTION TO ENGLISH LEGAL HISTORY 273 (2d ed. 1979)). As Baker describes it, the transition from the formalistic writs of covenant and debt into the more relaxed writ of assumpsit arose in part due to the law courts' jealousy of the Chancellor, and soon "the whole law of contract had been temporarily subsumed under the law of tort." *Id.* Compare this with modern concerns that promissory estoppel would signal the death of contract. See generally GRANT GILMORE, THE DEATH OF CONTRACT (1974). See also discussion *infra* Part III.C.

⁷² Frost, *supra* note 1, at 1362.

⁷³ See Fuller & Purdue, *supra* note 9, at 54.

⁷⁴ *Id.* at 56.

had never been formed.⁷⁵ Others suggest it places the promisee in the position he occupied prior to the contract's formation.⁷⁶ There is a substantial difference between the two in that the former brings the plaintiff up to the time of trial, while the latter returns him to a time in the past; this rhetorical inconsistency is a difference that opens up deliberation on the limiting principle,⁷⁷ the awarding of pre-contractual expenditures,⁷⁸ and the relevance of lost or forgone opportunity within the reliance interest.⁷⁹ Here, we must proceed with this caveat and—in deference to Fuller and Purdue's article, along with Williston⁸⁰—with the conclusion that the true measure of the reliance interest is the latter definition: that which would place the promisee in the position he occupied *prior to* the contract's formation.

B. Reliance Damages

The remedy of reliance damages, often referred to as out-of-pocket expenditures, will tend to (at least indirectly) satisfy the reliance interest discussed above. Courts will, however, issue these costs to the promisee as the best available approximation of the expectancy interest in cases where the expected profit would be too difficult to calculate.⁸¹

The first Restatement of Contracts (Restatement), drafted prior to Fuller and Purdue's article, provides for promissory estoppel,⁸² restitution,⁸³ and reliance damages in the form of expenditures "reasonably made in performance of the contract or in necessary preparation therefor [sic]."⁸⁴ This suggests that multiple reasons exist for the issuance of contract-related damages, even where no bargained-for exchange has taken place.⁸⁵

⁷⁵ See, e.g., DOUGLAS LAYCOCK, MODERN AMERICAN REMEDIES: CASES AND MATERIALS 41 (3d ed. 2002); Kelly, *supra* note 15, at 1766; Slawson, *supra* note 13, at 198.

⁷⁶ See, e.g., Fuller & Purdue, *supra* note 9, at 54; 24 WILLISTON, *supra* note 8, § 64:2, at 21; Gregory S. Crespi, *Recovering Pre-Contractual Expenditures as an Element of Reliance Damages*, 49 S.M.U. L. REV. 43, 45 (1995).

⁷⁷ Notably, this issue arises because courts ignore *both* of the justifications for reliance by referring to an expectancy cap, and therefore begin by trying to place the plaintiff-promisee in the position as though the contract had been performed. In this way, the limiting principle is entirely inconsistent with any proper theory of reliance, a point to which we will return later. See *infra* Part IV.C. for discussion.

⁷⁸ See discussion *infra* Part IV.E.

⁷⁹ See discussion *infra* Part IV.B.

⁸⁰ See *supra* notes 76-77 and accompanying text.

⁸¹ See Macaulay, *supra* note 38, at 289. See also *Mistletoe Express Serv. v. Locke*, 762 S.W.2d 637, 638 (Tex. App. 1988).

⁸² Rakoff, *supra* note 1, at 206 (citing RESTATEMENT OF CONTRACTS § 90 (1932)).

⁸³ *Id.* at 207 (citing RESTATEMENT OF CONTRACTS § 326, cmt. a (1932)).

⁸⁴ *Id.* (citing and quoting RESTATEMENT OF CONTRACTS § 333 & cmts. (1932)).

⁸⁵ See Knapp, *supra* note 57, at 1197.

As a witness to the influence of Fuller and Purdue's article, the second Restatement expressly endorses the three damage measures defined therein.⁸⁶ Section 349 reads as follows:

As an alternative to the measure of damages stated in § 347, the injured party has a right to damages based on his reliance interest, including expenditures made in preparation of performance or in performance, less any loss that the party in breach can prove with reasonable certainty the injured party would have suffered had the contract been performed.⁸⁷

The three damage measures are not equal in significance, though, as the overriding purpose of awarding damages is to "secure for that party the benefit of the bargain that he or she made by awarding a sum of money that will place the promisee in as good a position as he or she would have occupied had the contract been performed."⁸⁸ Still, when reliance damages are awarded, to include "any reasonably foreseeable costs incurred or expenditures made in reliance on the promise that has now been broken,"⁸⁹ the purpose of such an award is to return the plaintiff to "its precontractual position by putting a dollar value on the detriment the plaintiff incurred in reliance on the now-broken promise and reimbursing expenditures the plaintiff made in performing or preparing to perform its part of the contract."⁹⁰ The reliance measure's unequal treatment is also apparent in that § 349 does not follow the "pure" reliance interest,⁹¹ and instead limits recovery to what the promisor "can prove with reasonable certainty the injured party would have suffered had the contract been performed."⁹² Unsurprisingly, the Restatement also does not break with Fuller and Purdue to adopt the inclusion of pre-contractual expenditures.⁹³

Similar to the Restatement, the proposed revisions to Article 2 of the Uniform Commercial Code treat reliance damages as inferior to expectancy; however, this constitutes a step forward since reliance is precluded entirely by the current edition.⁹⁴ Overall, the primary purpose

⁸⁶ 24 WILLISTON, *supra* note 8, § 64:2, at 21 (citing RESTATEMENT (SECOND) OF CONTRACTS § 344 (1981)).

⁸⁷ RESTATEMENT (SECOND) OF CONTRACTS § 349 (1981).

⁸⁸ 24 WILLISTON, *supra* note 8, § 64:2, at 22.

⁸⁹ *Id.* § 64:2, at 31.

⁹⁰ *Id.* § 64:2, at 32.

⁹¹ See discussion of Fuller & Purdue's article, *supra* Part III.A.

⁹² See RESTATEMENT (SECOND) OF CONTRACTS § 349 (1981).

⁹³ See *id.*

⁹⁴ Michael T. Gibson, *Reliance Damages in the Law of Sales Under Article 2 of the Uniform Commercial Code*, 29 ARIZ. ST. L.J. 909, 1011-12 (1997).

of compensatory damages is to satisfy the non-breaching party's expectancy interest;⁹⁵ although, now in lieu of expectancy, damages may be "determined in any reasonable manner,"⁹⁶ thereby opening the door to reliance.⁹⁷

*C. Promissory Estoppel: Reliance-based Obligation
and the "Death of Contract"*

Having already addressed the potential confusion of reliance-based obligation, reliance interest, and reliance damages,⁹⁸ we turn now to the doctrine of promissory estoppel, which poses the most serious threat to unravel the progress made thus far. Referred to occasionally as "reliance,"⁹⁹ promissory estoppel also appears in the second Restatement:

(1) A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise. The remedy granted for breach may be limited as justice requires.¹⁰⁰

One author famously proclaimed that promissory estoppel, by returning contract theory to its tort-related origins, would bring about the death of contract.¹⁰¹ These fears may be justifiable, as courts have begun to use the doctrine as an independent basis of enforcement rather than as a fallback theory of recovery.¹⁰²

Most important for our purposes are two principles. First, promissory estoppel exists independently of reliance damages, especially because courts award expectancy damages in most cases where they base contractual obligation on this doctrine.¹⁰³ Second, reliance damages

⁹⁵ U.C.C. § 1-106(1)(a) (2001) (The remedies "must be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed.")

⁹⁶ See, e.g., Rev. U.C.C. § 2-703(2)(m) (2003).

⁹⁷ See Gibson, *supra* note 94, at 1011-12. The changes have also allowed for the award of restitution. See *id.*

⁹⁸ See discussion *supra* Part II.

⁹⁹ See, e.g., Barnett, *supra* note 61, at 518-19.

¹⁰⁰ RESTATEMENT (SECOND) OF CONTRACTS § 90(1) (1981).

¹⁰¹ See generally GILMORE, *supra* note 71.

¹⁰² Barnett, *supra* note 61, at 522-23 (citing Daniel A. Farber & John H. Matheson, *Beyond Promissory Estoppel: Contract Law and the "Invisible Handshake"*, 52 U. CHI. L. REV. 903, 907-10 (1985)). "[P]romissory estoppel is being transformed into a new theory of distinctly contractual obligation." *Id.* at 523 (quoting Farber & Matheson).

¹⁰³ See Wonnell, *supra* note 14, at 118 (citing Randy E. Barnett & Mary E. Becker, *Beyond Reliance: Promissory Estoppel, Contract Formalities, and Misrepresentation*, 15 HOFSTRA L. REV. 443 (1987)). This approach was also adopted by Williston in drafting the

exist independently from promissory estoppel, since they might be awarded where the basis for obligation is bargained-for consent¹⁰⁴—or even in equity, where a court does not enforce the contract at all.¹⁰⁵

IV. TOWARD AN IMPROVED RELIANCE REMEDY

A. *The Meaning of "Pure" Reliance*

A promisee's reliance interest can be defined as whatever might place that party into the position he occupied prior to entering into the contract.¹⁰⁶ Whether the reliance interest has merit within a consent-based contract system dominated by the expectancy interest—and what form the interest would therefore take—is the focus of this section.

Previous advocates of reliance as the primary interest—or at least a distinct interest—in contract law have not advanced a pure form of reliance that is true to its purpose of placing the promisee in the position he held prior to the contract's formation.¹⁰⁷ Often the problem lies in treating the reliance interest as placing the promisee in the position he would occupy *presently* had the contract not been made before, as in the case of those who call for the inclusion of lost opportunity damages.¹⁰⁸ Elsewhere, the problem lies in trying to satisfy two interests (expectancy and reliance) at once, producing results disloyal to the reliance interest as treated singularly. The consequence of this thinking has been the well-accepted limiting principle of reliance damages.¹⁰⁹ While critiquing both doctrines, this note will scrutinize the limiting principle with greater emphasis than it will examine lost opportunity damages, which have little practical application.

Other doctrines have been advanced that restrict the scope of the reliance interest unnecessarily. While these approaches to reliance are within the reasonable range of what we could call the "pure" form of the reliance interest, good arguments exist for taking an alternative route in each instance. First, the law of compensatory damages precludes the reliance interest due to its inferiority to the expectancy interest, rather than treating it as an alternative interest for the court to protect where

Restatement. Fuller & Purdue, *supra* note 9, at 64 (citing discussion of what is now § 90 of the CONTRACTS RESTATEMENT, in 4 A.L.I. PROC. app. at 98-99 (1926)).

¹⁰⁴ Macaulay, *supra* note 38, at 289. See generally *Mistletoe Express Serv. v. Locke*, 762 S.W.2d 637 (Tex. App. 1988).

¹⁰⁵ See, e.g., *Farash v. Sykes Datatronics, Inc.*, 452 N.E.2d 1245 (N.Y. 1983), discussed *infra* at Part IV.F.

¹⁰⁶ See, e.g., *Crespi*, *supra* note 76, at 45; 24 WILLISTON, *supra* note 8, § 64:2, at 21.

¹⁰⁷ Kelly, *supra* note 15, at 1760.

¹⁰⁸ See discussion *infra* Part IV.B. Here, something is added to the reliance interest.

¹⁰⁹ See discussion *infra* Part IV.C. Here, something conceptual is added to the reliance interest, although the practical effect is a decrease in the damages awarded.

appropriate.¹¹⁰ Underlying the prevailing approach are questions with respect to the nature of the wrong and the harm and whether the former causes the latter, which demand considerable treatment before the reliance interest could be given its independent status as protectable in law or equity,¹¹¹ without regard to the basis for contractual obligation.¹¹² Second, pre-contractual expenditures have also been precluded on the basis of causation defects and a failure to appreciate how the reliance interest might operate in conjunction with consent-based contractual obligation.¹¹³ Again, this note targets the latter doctrine more directly; however, in this instance, the doctrines both depend upon underlying issues of causation and the interplay of obligation and interest, allowing an opportunity to address the former as well.

B. Removing Lost Opportunity

Lost opportunity has not gained great support in commentary or the law, even where reliance damages have been discussed. While Fuller and Purdue included lost opportunity in their theoretical definition of the reliance interest, they left unanswered the question of whether lost opportunity ought to be compensable.¹¹⁴ The Restatement phrases reliance in terms of expenditures.¹¹⁵ Courts treat reliance as comprising only out-of-pocket expenses.¹¹⁶

Commentator Michael Kelly, a critic of the reliance interest, notes that “an award limited to expenditures . . . deviates from the reliance interest. It excludes any compensation for opportunity costs incurred by the plaintiff, leaving her less well off than she would have been if the contract had never been made.”¹¹⁷ But this claim depends upon a definition of the reliance interest that seeks to place the promisee in a position as though the contract had never been made. By accounting for lost opportunity, the reliance interest would receive similar treatment as expectancy in its emphasis on what might have been. In a perfect market, in fact, the expectancy interest will always match the reliance interest that includes lost opportunity because what the promisee lost within the contract would equal what he would have gained in a deal

¹¹⁰ See discussion of the Restatement and Uniform Commercial Code, *supra* Part III.B.

¹¹¹ See discussion *infra* Part IV.D.

¹¹² See discussion *infra* Part IV.E.

¹¹³ See discussion *infra* Part IV.D.

¹¹⁴ Fuller & Purdue, *supra* note 9, at 55.

¹¹⁵ See RESTATEMENT (SECOND) OF CONTRACTS § 349 (1981).

¹¹⁶ Frost, *supra* note 1, at 1375.

¹¹⁷ Kelly, *supra* note 15, at 1766.

with any other person.¹¹⁸ Given two theoretically identical interests, we could scarcely justify retaining both.

If, however, the definition set forth in this note holds, then the reliance interest appears more like restitution than expectancy, in that it resets the relationship between promisor and promisee by undoing the adverse consequences, rather than giving the expected profit. Reliance and restitution are theoretically different, despite potential cases where the two converge,¹¹⁹ in that the measure for the reliance interest centers on harm to the promisee, whereas the measure for the restitution interest centers on the benefit to the promisor.

Practically speaking, discussions concerning lost opportunity are moot. Todd Rakoff suggests that “inclusion of loss of opportunity within (the) reliance interest makes it impossible . . . to insist on a purely tangible notion of injury,”¹²⁰ because “the value of these will often be impossible to measure.”¹²¹ Where the expected profit of a particular contract cannot be reasonably proven, one could hardly think that the value of similar opportunities lost as a result of the breach can possibly escape a similar fate.¹²² Factor in the potential speculation as to what opportunity the promisee would have taken,¹²³ and it seems at least problematic—if not all but impossible—for courts to ever make such calculations.

C. *The Case Against the Limiting Principle*

As egregious as the error that produces the lost opportunity addition to the reliance interest, a greater one justifies the limiting principle, which is the puzzling rule that a promisee’s reliance damages may not exceed what he was expected to recover on the contract¹²⁴—and, in practice, that a promisor may prove the loss avoided to the promisee by way of the promisor’s breach.¹²⁵ Here, Kelly has a valid grievance in

¹¹⁸ Pettit, *supra* note 30, at 421-22.

¹¹⁹ If the detriment to the promisee equals the benefit to the promisor, the reliance and restitution interests will match exactly in amount.

¹²⁰ Rakoff, *supra* note 1, at 221.

¹²¹ *Id.*

¹²² David Slawson discusses the various difficulties faced in valuing lost opportunity. *See* Slawson, *supra* note 13, at 220.

¹²³ *See id.*

¹²⁴ Admittedly, though the theoretical stakes are high, the actual cases where courts invoke the limiting principle are rare. Rakoff, *supra* note 1, at 229 (citing L.L. Fuller & William R. Purdue, *The Reliance Interest in Contract Damages*, 46 YALE L.J. 52, 75 (1936)).

¹²⁵ *Mistletoe Express Serv. v. Locke*, 762 S.W.2d 637, 638-39 (Tex. App. 1988). This case presents a good example of how the limiting principle works. There, the promisee (Locke) incurred several expenses in order to provide a pickup and delivery service for the promisor (Mistletoe). *Id.* at 638. The majority noted that Mistletoe “is not entitled to have Locke’s losses deducted from the recovery, because Mistletoe had the burden to prove that

saying that “[a]ny principled effort to vindicate the reliance interest should not lightly impose those expectation losses on the plaintiff.”¹²⁶ This is because the limiting principle “treats the promised performance as the starting point for analysis,”¹²⁷ rather than the harm suffered in reliance on the promise itself. Again, where the reliance interest purports to place the promisee in the position he occupied prior to the contract, a court seeking to satisfy this interest betrays this logic by referring also to the position the promisee would have occupied had the contract been fulfilled—or, the expectancy interest.¹²⁸

A counter-argument to this analysis would be that courts do not actually seek to satisfy a promisee’s reliance interest even where it awards the out-of-pocket component of the overall interest. Instead, a court will award expenditures because a “party’s reasonable expectation of profit includes recouping the capital investment.”¹²⁹ Even given that the pure reliance interest definition does not warrant in itself a limitation imposed by the expectancy measure, courts uninterested in protecting the reliance interest have no definitional hurdle to keep them from imposing such a limit; there remains a case to be made for pure reliance damages in the world of the expectancy interest.

When choosing to implement the limiting principle of reliance damages, courts allocate some risk to the promisee, who then bears the loss of having made a bad deal.¹³⁰ The pure reliance remedy, by contrast, places that risk on the promisor, “who must pay all of the [promisee’s] expenditures if the [promisee] made a bad deal, and pay expenditures plus profit if the [promisee] made a good deal.”¹³¹ On its face, the latter result appears unjust; it appears to constitute a penalty for breach, despite the well-accepted rule that punitive damages will not be

amount, if any, and it did not do so.” *Id.* at 639. The concurring justice argued against this result “when the loss figure is not available because of the fault of the party suffering the loss.” *Id.* at 639 (Grant, J., concurring).

¹²⁶ Kelly, *supra* note 15, at 1763.

¹²⁷ Rakoff, *supra* note 1, at 231.

¹²⁸ As noted above, where the reliance interest includes lost opportunity it will equal the expectancy interest in a perfect market. Because plaintiff would have lost money *in any other similar deal*, it would be easy to see why a reliance interest containing lost opportunity might be capped by the expectancy measure, since that amount best approximates this form of the reliance interest in many instances. Without lost opportunity as a component of the reliance interest, the argument for capping reliance becomes more problematic. Where Kelly argues that “[r]eliance limited by expectation deviates dramatically from the position the plaintiff *would have occupied if the defendant had not made the promise*—the ideal toward which the reliance interest allegedly strives,” his erroneous definition of reliance renders this statement a half-truth. *See* Kelly, *supra* note 15, at 1760 (emphasis added).

¹²⁹ *See* Mistletoe Express Serv. v. Locke, 762 S.W.2d 637, 638 (Tex. App. 1988).

¹³⁰ Kelly, *supra* note 15, at 1772.

¹³¹ *Id.*

available in a contract-based cause of action.¹³² If the promisee expected to recover his expenditures through the performance of the contract, and the promisor can prove that this was not possible, then how can the promisee expect to recover the expenditures in a claim for breach?¹³³ To find otherwise, a court would have to recognize a different allocation of risk than the parties bargained for initially. But is there any basis for a court to do so?

At the time of litigation, in cases where the promisee has been excused from performance, the promisor has committed a material breach.¹³⁴ Notably, then, “[a] party who first commits a material breach cannot enforce the contract.”¹³⁵ This raises a serious question: “Why should the aggrieved party be bound to the limits of the expectations derived from a norm which the [promisor] has denied by the very breach?”¹³⁶

In a contract action, a promisee must prove the following elements, with one or two of these absent depending upon the jurisdiction: (1) the existence of a valid contract; (2) the terms of the contract; (3) promisee’s performance; (4) promisor’s breach; and (5) damages resulting from that breach.¹³⁷

Thus, a promisee must allege damages, but those may only include the expenditures made in reliance on the promise. Nothing binds the promisee to assert the expectancy damages; therefore he has not enforced the contract by suing for compensation of that interest. Neither, then, should the promisor be allowed to offer evidence related to the expected loss or profit of the contract.¹³⁸ Thus, the promisor shall have shifted the burden of a promisee’s bad deal over to himself by reason of his breach and thereby through his inability to offer this evidence.¹³⁹

¹³² 11 CORBIN, *supra* note 22, § 1077, at 380.

¹³³ “[H]ad the contract been performed, the expenditures would have nevertheless been made, but would not have been lost. . . . At least, this is the situation in cases in which the expenditures do not exceed the expectation interest.” Miguel Deutch, *Reliance Damages Stemming from Breach of Contract: Further Reflections and the Israeli Experience*, 99 COM. L.J. 446, 449 (1994).

¹³⁴ 23 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 63:3, at 438-39 (4th ed. 2002).

¹³⁵ *Id.* § 63:3, at 443.

¹³⁶ Deutch, *supra* note 133, at 460.

¹³⁷ *Momah v. Albert Einstein Med. Ctr.*, 978 F. Supp. 621, 636 (E.D. Pa. 1997) (interpreting Pennsylvania law), *aff’d* 229 F.3d 1138 (3d Cir. 2000).

¹³⁸ We might say the promisor has *waived* the opportunity to offer evidence as to the expected loss or is *estopped* from it where the promisee only claims expenditure damages for his reliance on the contract; either way, the effect is to allow the promisee to recover all expenditures reasonably made in performance on the contract.

¹³⁹ Note that an inability to offer *sufficient* evidence in this regard leads to the same result, but here the argument carries this further to bar the offer of any such evidence. *See*

An immediate objection at this point is that under modern contract law, the “wrong” is the promisor’s breach, and the “injury” is the promisee’s expenditures that will not be recovered. Here, however, they would not have been recovered anyhow; therefore, no injury has taken place. This game of semantics deprives a promisee of compensation where a different understanding of the “wrong” and “injury” would just as easily provide a different result, as will be demonstrated below.¹⁴⁰ For now, three reasons suggest the fairness of barring a promisor from offering evidence that would limit a promisee’s recovery: (1) the tendency of courts to under-compensate promisees, especially with respect to noneconomic damages; (2) the initial freedom to contract for a different remedy; and (3) the ability to engage in *ex post* negotiation.

A dominant principle in contract law is that a promisee will receive nothing more than what would restore his rightful position, according to Aristotelian corrective justice.¹⁴¹ In practice, however, “[o]ur legal system seldom puts aggrieved parties where they would have been had breaching parties performed.”¹⁴² This results from the absence of awards for attorney fees and court costs,¹⁴³ and also from a court’s inability to address noneconomic losses.¹⁴⁴ Not that advocates of the reliance interest have anything more to offer the promisee where the reliance measure usually gives less than the expectancy measure. Where the *expenditure measure*¹⁴⁵ version advocated by reliance scholars dominates, courts will “award the smallest recovery they can rationalize, choosing either the (promisee’s) expenditures or the expectation interest.”¹⁴⁶ By sharp contrast, the pure reliance remedy will be “[e]xpectation or [e]xpenditures, whichever is higher.”¹⁴⁷ If a reasonable basis exists for a higher recovery, then courts ought to allow the higher recovery in light of the relief sought by the promisee.

Another dominant principle of contract is the freedom of parties, within certain limits, to create and shape a legal duty with respect to another person.¹⁴⁸ Thus, default remedies of the courts leave room for

Mistletoe Express Serv. v. Locke, 762 S.W.2d 637, 639 (Tex. App. 1988) (Grant, J., concurring).

¹⁴⁰ See discussion *infra* Part IV.D.

¹⁴¹ DiMatteo, *supra* note 39, at 844.

¹⁴² Macaulay, *supra* note 38, at 250.

¹⁴³ *Id.* at 252.

¹⁴⁴ See *id.* at 249-52.

¹⁴⁵ That is, out-of-pocket expenses capped by the expectancy measure. See Kelly, *supra* note 15, at 1772.

¹⁴⁶ *Id.*

¹⁴⁷ *Id.* at 1771.

¹⁴⁸ GRACE MCLANE GIESEL, 15 CORBIN ON CONTRACTS § 79.4, at 20-21 (Joseph M. Perillo ed., 2003).

parties to opt for alternative remedies in the event of breach, leading some to view the default remedies as merely affecting the initial and subsequent negotiations of the parties.¹⁴⁹ That a promisor has every opportunity to bargain for a better remedy and not take any chances with a potentially adverse award of expenditures (which happens to exceed the expectancy measure) alleviates any harshness this rule might have—especially when the promisor has drafted the contract.¹⁵⁰

Moreover, the exclusion of the limiting principle creates an incentive for the promisor to renegotiate (through *ex post* negotiation) rather than to breach the agreement.¹⁵¹ This has the advantage of better accounting for noneconomic factors that may cause a promisee to prefer performance over breach, even where he stands to lose money on the deal.¹⁵² By forcing the promisor to seek out the promisee, this solution balances the interests of the parties and ensures that the promisor will perform or compensate the promisee where the latter's noneconomic interests outweigh his prospect for losing money.¹⁵³

D. Causation and the Interplay Between Basis and Interest

Let us return now to a consideration of “wrong” and “injury” as it relates to the limiting principle and to the issue of whether to award pre-contractual expenditures. Within the reliance interest, the wrong is “the making of a promise that induced the promisee to change her position to her detriment”;¹⁵⁴ however, within the expectation interest, the wrong is

¹⁴⁹ See Craswell, *supra* note 24, at 107.

¹⁵⁰ See MARGARET N. KNIFFIN, 5 CORBIN ON CONTRACTS § 24.27, at 282-83 (Joseph M. Perillo ed., 1998).

¹⁵¹ A 1992 survey of businesspeople indicates that contract disputes frequently spur amicable renegotiation. Russell J. Weintraub, *A Survey of Contract Practice and Policy*, 1992 WIS. L. REV. 1, 22-23. The question specifically asks, “Describe your company’s experience when it has asked relief from or modification of its contractual obligations.” *Id.* at 22. Eighty-seven percent of respondents had experienced an “amicable working out of the problem by modification of performance of the contract in question,” and sixty-six percent had experienced an “amicable working out of the problem by adjustments in future contracts.” *Id.* at 23.

¹⁵² Deutch, *supra* note 133, at 451.

[T]he rationale of the contention denying causation in regard to losses exceeding expectation is . . . that the expenditures would have been wasted anyway, even if the contract had been performed. Yet, this approach ignores an important aspect. It limits the meaning of performance only to its economic value, neglecting its other possible meanings.

Id.

¹⁵³ Note that transactional barriers and the relative bargaining positions of the parties affect *ex post* negotiation as much as any other type. Wonnell, *supra* note 14, at 84.

¹⁵⁴ *Id.* at 54.

“the breaking of a promise.”¹⁵⁵ For a wrong to cause an injury, the injury must take place concurrently or at a later time than the wrong, so that pure reliance damages cannot result from a breach because the damages occurred before the wrong.¹⁵⁶ But, if the out-of-pocket expenditures were expected to be recovered through performance of the contract, then a breach does cause this narrower component of reliance damages.¹⁵⁷ Similarly, for a wrong to *proximately* cause an injury, there must not be a substantial intervening cause, so that expectation damages cannot result from a promise where the substantial intervening cause of that injury is the breaking of that promise.¹⁵⁸

By focusing on the promise or the breach as specific points where a wrong has taken place, contract scholars have overly-complicated the picture.¹⁵⁹ It also seems odd, on the one hand, to actively disclaim any true culpability on the part of a promisor¹⁶⁰ and, on the other, to look so carefully at the point of “wrongdoing” that triggered an injury.¹⁶¹ Contract law is better served by a conception of the contract itself—being an agreement that ultimately fails to actualize during the executory period—as the wrong, where the breach or anticipatory repudiation manifests that wrong.¹⁶² Judges themselves enjoy this “big picture” perspective because they see both the promise and the breach in

¹⁵⁵ *Id.*

¹⁵⁶ See Deutch, *supra* note 133, at 448.

¹⁵⁷ See *id.*

¹⁵⁸ That courts have given expectancy damages in promissory estoppel cases does not violate this principle. The reliance in question causes a contractual obligation, the breach of which has given rise to an action.

¹⁵⁹ Christopher Wonnell links these two decisions of the promisor, to initially make and to later break the promise, to the reliance and expectancy interests, respectively. Wonnell, *supra* note 14, at 56. Formation and breach have their places in other corners of contract law, but where the question is the fairness of remedying a particular harm, these concepts can interfere with a just result. Having conceded to expectation as the dominant interest in contracts, the present note argues for room in which reliance damages—in the form of expenditures—be allowed to satisfy the reliance interest where the promisee pleads in this way. In doing so, the current section aims broadly in justifying a remedy geared toward a harm that occurs prior to the previously conceptualized wrong. Arguments favoring the reliance interest, such as the attempt made by Wonnell to marry the two wrongs (thus marrying the interests), do not lie within the scope of the present note. See *id.* at 90.

¹⁶⁰ This is indicated by the preclusion of punitive damages in contract actions. See 11 CORBIN, *supra* note 22, § 1077, at 381.

¹⁶¹ See, e.g., Wonnell, *supra* note 14, at 54.

¹⁶² There is a reason, then, that anticipatory repudiation may give rise to a suit before the breach was ever possible: the agreement or contract has proven itself a worthless one, in the sense that performance on the promisor’s part will not be forthcoming.

hindsight.¹⁶³

This larger umbrella eliminates causation issues and gives room for inquiry as to any of the three interests and their related measures whenever an obligation has been created. In the event that the agreement falls through, a promisee ought to receive compensation for any reasonable injury arising from that agreement, not to include double recovery based on more than one theory of damages.¹⁶⁴

E. The Case for Awarding Pre-contractual Expenditures

As a final proposed reform to reliance damages, the rule on whether to award pre-contractual expenditures has less to do with the foregoing discussion and more to do with the formation of a contract; still, even with a workable definition of the contractual wrong that addresses causal concerns as to post-contractual expenditures, a new concern arises in this context: how could expenditures prior to an agreement possibly be imposed on the promisor if not caused by that agreement?

Before we develop a reply to the larger problem thus presented, consider two minor objections one might possibly make to such an award. First, a promisee who takes risks prior to forming the contract should have to suffer the consequences of taking those risks. Second, modern contract law has, as in the case of rejecting past consideration, generally opposed the inclusion of previous events within the contract.

To answer the first objection, although a promisee takes great risk in making pre-contractual expenditures, he does so only until the promisor signs the contract. The gamble in this situation is not whether the promisor will complete performance on the contract, thereby allowing the promisee to recover those pre-contractual expenses.¹⁶⁵ Instead, the promisee gambles on reaching a bargained-for agreement with the promisor, at which point the latter assumes potential liability for those expenditures reasonably given to him. To answer the second objection, the difference between past consideration and pre-contractual expenditures is that past events cannot support a *nudum pactum* (an

¹⁶³ In judgment of Israel, God occupied a similar perspective. Of course, it would appear that He knew beforehand of both the promise and the breach, but in allowance for free will (to the extent that it is compatible with predestination) reserved judgment for afterward—where in hindsight He could likewise see both the making and the breaking of the promise. Based on Aaron's caveats given when the people first made a covenant (that they would be witnesses against themselves when the covenant was broken), and on God's specific criticism of their failure to keep their end of the deal, it seems the concern was for the covenant in its entirety, from formation to breach. See *Jeremiah* 11:1-8; *Joshua* 24:14-27.

¹⁶⁴ The wrong is the agreement that fails to actualize; the harm is determined according to the relief sought by a promisee.

¹⁶⁵ Or, in the event of breach, to lose those expenses.

unenforceable agreement),¹⁶⁶ but can potentially constitute part of an agreement enforceable on other grounds. At least, nothing prevents parties from contracting with respect to expenditures already made.

Must an agreement that the promisor assumes liability on past expenses be explicit, or can a court infer it under the circumstances? With the rise of consent-based obligation, courts have adopted an objective standard for determining whether a condition may be implied in fact.¹⁶⁷ Apart from precedent, nothing precludes a court from applying this objective analysis to the question of whether the parties included liability for the pre-contractual expenditures as a part of the agreement. The test, as commentator Gregory Crespi proposes, ought to be that courts will impose a pre-contractual expenditure “when it is in the reasonable contemplation of the parties to the contract, at the time of formation, that those expenditures will likely be wasted in the event of breach.”¹⁶⁸

Given that the terms of a contract will include pre-contractual expenditures when they are awardable,¹⁶⁹ causation issues pose no more difficulty for these expenditures than for any other injury arising from the enforceable agreement that fails to actualize.¹⁷⁰

¹⁶⁶ See 3 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 7.2, at 17 (4th ed., 1992).

¹⁶⁷ Williston places conditions implied in fact into the class of express conditions, as opposed to constructive conditions implied in law, because these are created “by the manifested intention of the parties to a contract” rather than imposed by the courts. 13 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 38:11, at 419-21 (4th ed., 2000). Surrounding circumstances, in addition to the language of the parties, may be used to imply conditions in fact. *Id.* Nor does the parol evidence rule preclude investigation of surrounding circumstances as a rule of interpretation. 11 SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 32:7, at 434-39 (Richard A. Lord ed., 1999).

¹⁶⁸ Crespi, *supra* note 76, at 47. Crespi adds to this the standard principles of foreseeability, avoidability, certainty, and the limiting principle—as well as the idea that the parties may contract otherwise. *Id.* Naturally, the present note splits with Crespi on the limiting principle, but otherwise this forms a solid blueprint.

¹⁶⁹ *But see id.* at 47-51. Crespi first justifies the award of pre-contractual expenditures on the notion that the lost opportunities in reliance are never compensated. *Id.* However, later in the article he mentions that “at the moment of contracting those expenditures are irrevocably committed to the objective of contract performance by the plaintiff,” in apparent harmony with this mutual assent argument. *Id.* at 66.

¹⁷⁰ When these expenditures are awarded in the context of the expectancy interest, the promisee had a reasonable belief that he would have recouped these losses. When they are given in the context of the reliance interest, they are treated similarly with other expenditures pleaded as such.

F. Reliance as Equity

Until this point, the discussion has centered on reliance as a measure of damages at law. Alternatively, the reliance interest has great potential in equity, as a New York Court of Appeals case will reveal.

In *Farash v. Sykes Datatronics, Inc.*, the plaintiff brought a claim for breach of an oral lease for a term longer than a year, and was therefore barred by the Statute of Frauds.¹⁷¹ He also sought, on an alternative claim, “to recover for the value of the work performed by plaintiff in reliance on statements by and at the request of defendant,”¹⁷² which would require the court to declare a contract implied in law.¹⁷³

Concerning restitution, the court quoted:

“[T]he law should impose on the wrongdoing defendant a duty to restore the plaintiff’s former status, not merely to surrender any enrichment or benefit that he may unjustly hold or have received; although if the market value or, in the absence of a market value, the benefit to the defendant of what has been furnished exceeds the cost or value to the plaintiff, *there is no reason why recovery of this excess should not be allowed.*”¹⁷⁴

And, here, the court goes on to grant “restitution” for part performance:

“The quasi-contractual concept of benefit continues to be recognized by the rule that the defendant must have received the plaintiff’s performance; acts merely preparatory to performance will not justify an action for restitution. ‘Receipt,’ however, is a legal concept rather than a description of physical fact. If what the plaintiff has done is part of the agreed exchange, it is deemed to be ‘received’ by the defendant.”¹⁷⁵

It is not that the decision presents any miraculous leap of logic. According to the second Restatement, with two unrelated exceptions, “any performance which is bargained for is consideration.”¹⁷⁶ In the preceding section, it says that a performance “is bargained for if it is sought by the promisor in exchange for his promise and is given by the

¹⁷¹ *Farash v. Sykes Datatronics, Inc.*, 452 N.E.2d 1245, 1246 (N.Y. 1983).

¹⁷² *Id.*

¹⁷³ *Id.* at 1247.

¹⁷⁴ *Id.* at 1247-48 (quoting 12 SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACTS, at 282-84, 286-87 (3d ed. 1979) (notes omitted)) (emphasis added).

¹⁷⁵ *Id.* at 1248 (quoting JOHN D. CALAMARI & JOSEPH M. PERILLO, CONTRACTS § 15-4, at 574 (2d ed. West 1977)).

¹⁷⁶ RESTATEMENT (SECOND) OF CONTRACTS § 72 (1981).

promisee in exchange for that promise.”¹⁷⁷ Notwithstanding the fact that reliance itself does not amount to consideration in the absence of a bargain, this suggests that the rendering of a performance constitutes enrichment of the promisor, which equity has every reason to take from him in the event of breach. Following this reasoning, reliance would not be available as an equitable remedy where the performance does not amount to consideration. On the other hand, courts should feel free to award the reliance interest in equity whenever the promisee chooses to rescind the agreement—to include situations where the contract was valid but unenforceable, or where the promisee would rather seek to recover expenditures because the contract had been a losing one.¹⁷⁸

V. CONCLUSION

When courts enforce an agreement, they first determine whether that agreement is valid and enforceable, and then decide how to measure the award given to a promisee, governed by the potential interests at stake within an action for damages due to a breach (or, alternatively, for restitution or specific performance). The law has not historically or recently determined an appropriate remedy solely on the basis of what made the agreement valid and enforceable. In fact, this note has shown that a remedies analysis appropriately treats basis, interest, and remedy independently (though with some logical consistency).

Reliance damages—defined as out-of-pocket expenditures—fit easily within the consent-based, expectancy-interest concept of contract remedies. Yet in order to make a promisee whole, the reliance interest can help to shape certain doctrines. Reliance should not include a lost opportunity component for definitional reasons, but also because the expectancy measure, where possible, best approximates this amount. Reliance should not be limited by the expectancy measure, even though the expectancy interest suggests this result, because a promisor by way of breaching the agreement should have no recourse to that agreement in offering evidence of a “losing contract.” Reliance should also not be restricted to post-contractual expenditures where the parties reasonably contemplated that the promisor would have liability for certain pre-contractual expenditures made by the promisee.

In lieu of or in addition to these proposed changes, the reliance interest has a potential home within the realm of equity, since a promisor is unjustly enriched by the consideration given by the promisee

¹⁷⁷ *Id.* § 71(2).

¹⁷⁸ Note that to rescind a contract, a promisee would have to forgo any pre-contractual expenditures that might have been imposed upon the promisor because the act of rescission removes any contractual liability of either party in order to allow for an equitable solution.

who performs on the contract. Thus, reliance would deserve as much protection as restitution, and a promisee would have the opportunity to rescind a contract and receive the value of the consideration given to the promisor.

William Hart