EXPECTATION DAMAGES RULE UNDER AMERICAN CONTRACT LAW

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ABSTRACT

Under American contract law, the most common used basis for calculation of damages is expectation damages rule when there is a breach of contract. The rule was finalized in Robinson v Harman. The rule is now reflected in Uniform Commercial Code and the restatement (second) of contract. It is still the most common principal of calculating damages used by court. After a century's development, the rule had developed three restrictions, which are foreseeability restrictions, mitigation liability and certainty restriction.

Under common law, the most common remedy for breach of contract is monetary damages rather than specific performance, which is different from civil law. The purpose of monetary damages is to provide the aggrieved party compensation.

DEFINITION OF EXPECTATION DAMAGES

American jurist Fuller and his students distinguished the damages into three categories, which are expectation interests, reliance interests and restitution interests. When there is a breach of contract, monetary damages can protect these three interests. The calculations of monetary damages are based on these three interests as well. Expectation interests are to put the aggrieved party in position he would have been in had the contract been performed. Reliance interests are to (losses incurred due to expectation) to put the aggrieved party in the position he would have been in had the contract never been made. Restitution interests are to put the aggrieved party back in the position he would have been in had the promise never been made. Expectation interests is the earliest established monetary damages rule among these three interests, which is still widely used today.

Expectation interests, in other words, is all the interests the party hope to achieve through the performance of contract. The purpose of American contract law is to protect the "hope" or "expectation" arisen from agreement by putting the injured party where he would have been if the contract had been performed. Although expectation interest grants the injured party interest that he would receive had the contract been performed, there are reasonability and realistic behind this rule. The rationale behind this rule is that the aggrieved party had done some preparations for realizing this expectation. Realizing the party's expectation interests has basis and condition due to these preparations. What's more, since expectation interests is reasonable interests which parties of contract hope to achieve when they sign the contract, the default party shall be and could be liable for his foreseeable conduct. And default party is not liable for unexpected situations, as he does not expect those situations would occur and he does not have the right to choose when he signs the contract. It is important to note that expectation damages are not punitive; its theoretical purpose is to place the injured, non-breaching party in the same position that they would have occupied had there been full performance of the contract. In other words, it is the amount that makes the injured party indifferent to the breach.

There is direct provision in restatement of contract about applying expectation interest. In accordance with restatement (second) of contract section 347, the injured party has a right to damages based on his expectation interest. Although restatement (second) of contract is not legislation, many of its rules are already adopted by many states and very often judges will use it as important reference in their judgements. Under uniformed commercial code article one section 305 (1), the remedies provided by [the Uniform Commercial Code] must be liberally administered to the end that the aggrieved party maybe put in as good a position as if the other party had fully performed but neither-consequential or special damages nor penal damages may be had except as specifically provided in [the Uniform Commercial Code] or by other rule of law. Although there is no direct stipulation about expectation interests, but what UCC prescribes here has the same effect of expectation interests.

1. *Case that established expectation interest rule*

The first case that used expectation interest rule is Robinson v Harman, an English contract law case. Harman wrote to Robinson offering him a 21-year lease of a dwelling house in Croydon. He subsequently changed his mind and refused to complete the lease when he discovered the property was worth more than the agreed price. Robinson's solicitor had enquired as to the nature of Harman's title, and had been assured he was absolutely entitled to grant the lease. The property was actually vested in trustees and Harman was only entitled to a portion of the property. Robinson brought an action for damages. The Court of Exchequer Chamber held that where a party agrees to grant a good and valid lease, having full knowledge that he has no title, the plainti3, in an action for the breach of such agreement, may recover, beyond his expenses, damages resulting from the loss of his bargain; and the defendant cannot, under a plea of payment of money into court, give evidence that the plaintiff was aware of the defect of title. This case comes within the latter, by which the old common-law rule has been restored. Therefore, the defendant, having undertaken to grant a valid lease, not having any color of title, must pay the loss which the plaintiff has sustained by not having that for which he contracted.

2. *Restrictions about expectation interests*

After the establishment of expectation interest rule, the courts found that if there were no restrictions about this rule, the damages could be too large for the default party. And thus, they established some restrictions on this rule, which are foreseeability limitations, mitigation limitations and certainty limitation.

a. Foreseeability limitations

The foreseeability limitation originated back to the famous Hadley v. Baxendale case. In this case, plaintiff Miller entered into a contract with defendant Pickford & Co. for the purpose of having the broken shaft carried to Greenwich to be repaired, who was the manufacturer of the shaft. Pickford & Co. breached the contract by not deliver the shaft in time as agreed in contract. The plaintiff sued for lost of profit they would receive if the shaft was delivered in time. The judge decided that Pickford & Co. was only liable for damages which it ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising in usual course of things or such as may reasonably be supposed to have been the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it. This rule is also called "Hadley" rule. It was widely used bt the courts in America after 1845. The rule finally developed into two situations that the court would consider as foreseeable situations. The first category of losses that would be consider as foreseeable as a probable result of a breach is that would happen in the ordinary course of events. And the second category of losses that would be considered as a probable result of a breach is that would be as a result of special circumstances, beyond the ordinary course of events, that the party in breach had reason to know. These two categories also help classify damages. Damages that arising from ordinary course of things is called "general damages", while damages that arising from special circumstance is called "special damages". General damages presume the parties could foresee the result of its breach, and thus injured party does not bear the burden of proof of foreseeability. If the losses injured party suffer from the breach of default party are arising from the normal course of dealings. Otherwise, the aggrieved party shall bear the burden of proof that the default party could foresee the losses of injured party when the contract was made. Normally, the calculation of damages is based on the lost value arise from the breach, and the default party shall pay the damages no matter the breach is due to negligence or lack of experience, because the law has a presumption that a reasonable person could foresee the damages when the contract was made. There are relevant provisions about the calculation of damages in Uniform Commercial Code second article, the measure of damages for non-acceptance or repudiation by the buyer is the difference between the market price at the time and place for tender and the unpaid contract price together with any incidental damages, but less expenses saved in consequence of the buyer's breach.

A contracting party is generally expected to take account of those risks that are foreseeable at the time he makes the contract. He is not, however, liable in the event of breach for loss that he did not at the time of contracting have reason to foresee as a probable result of such a breach. The mere circumstance that some loss was foreseeable, or even that some loss of the same general kind was foreseeable, will not suffice if the loss that actually occurred was not foreseeable. It is enough, however, that the loss was foreseeable as a probable, as distinguished from a necessary, result of his breach. Furthermore, the party in breach need not have made a "tacit agreement" to be liable for the loss. Nor must he have had the loss in mind when making the contract, for the test is an objective one based on what he had reason to foresee. There is no requirement of foreseeability with respect to the injured party. In spite of these qualifications, the requirement of foreseeability is a more severe limitation of liability than is the requirement of substantial or "proximate" cause in the case of an action in tort or for breach of warranty. Although the recovery that is precluded by the limitation of foreseeability is usually based on the expectation interest and takes the form of lost profits, the limitation may also preclude recovery based on the reliance interest.

It is not always in the interest of justice to require the party in breach to pay damages for all of the foreseeable loss that he has caused. There are unusual instances in which it appears from the circumstances either that the parties assumed that one of them would not bear the risk of a particular loss or that, although there was no such assumption, it would be unjust to put the risk on that party. One such circumstance is an extreme disproportion between the loss and the price charged by the party whose liability for that loss is in question. The fact that the price is relatively small suggests that it was not intended to cover the risk of such liability. Another such circumstance is an informality of dealing, including the absence of a detailed written contract, which indicates that there was no careful attempt to allocate all of the risks. The fact that the parties did not attempt to delineate with precision all of the risks justifies a court in attempting to allocate them fairly. The limitations dealt with in this Section are more likely to be imposed in connection with contracts that do not arise in a commercial setting. Typical examples of limitations imposed on damages under this discretionary power involve the denial of recovery for loss of profits and the restriction of damages to loss incurred in reliance on the contract. Sometimes these limits are covertly imposed, by means of an especially demanding requirement of foreseeability or of certainty. The rule stated in this Section recognizes that what is done in such cases is the imposition of a limitation in the interests of justice.

b. Mitigation limitation

Although the default party breach his promise and cause losses from contract interests, the law design mitigation limitation to restrict injured party's damages to avoid unjust situations to default party. It is also called avoidability as a limitation on damages. This rule requires the injured party stop his performance immediately if there is a breach of contract and take actions to avoid expansion of losses. If the interests of the aggrieved party will be impaired when the injured party takes actions to avoid further losses, then he is not required to adopt measures to mitigate the losses. Restatement of contract only require the injured party to avoid damages without undue risks, burden and humiliation. In other words, losses that can be avoid through injured party's reasonable measures are deemed to be damages not arise from the breach, and thus injured party cannot recover losses that could be avoid through reasonable measures. Mitigation limitation rule encourages injured party to actively take measures to mitigate losses, which reflects the characters of economic efficiency of contract. Under Uniform Commercial Code article two, part VII, calculation of damages with respect to seller and buyer are different, as only the buyer has consequential damages. But they both have mitigation liability when there is a breach of contract. Measure of damages for non-acceptance or repudiation by the buyer is the difference between the market price at the time and place for tender and the unpaid contract price together with any incidental damages provided in this Article (Section 2–710), but less expenses saved in consequence of the buyer's breach. While the measure of damages for non-delivery or repudiation by the seller is the difference between the market price at the time when the buyer learned of the breach and the contract price together with any incidental and consequential damages, but less expenses saved in consequence of the seller's breach. Where the buyer has accepted goods and given notification he may recover as damages for any non-conformity of tender the loss resulting in the ordinary course of events from the seller's breach as determined in any manner which is reasonable. The measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount. Therefore, we can see both seller and buyer have the liability to mitigate their losses by either resale the goods or buy the same tender goods in market. Only aggrieved party fulfil his mitigation obligation after a breach, he is entitled to the damages of loss of values plus incidental and consequential damages.

c. *Certainty limitation*

Certainty is critical to court in support of damages claimed by plaintiff, as only damages with "reasonable certainty" can be recovered. Standard of damages with certainty requires exact and clear evidence to prove the losses rather than speculative and accidental losses. The evidence needs to show the fact and amount of damages to satisfy the requirement of reasonable certainty. The original purpose of establishing certainty rule is same as that of expectation rule, which is to avoid jury's abuse of discretion power to award damage on the one hand and balancing the interest of injured party and default party.

It is hard to prove that loss of profits is the result of defendant's breach even if it satisfies the requirement of foreseeability, especially when the court need to decide whether the business of injured party can be success or not, which is affected by a lot of accidental factors. For example, in the famous Chicago Coliseum Club v. Dempsey case, Chicago Coliseum Club, the plaintiff, entered into a contract with boxer Harry Wills, and subsequently, a separate contract with Jack Dempsey, the defendant. The contracts stated that Wills and Dempsey would fight for the heavyweight championship sometime in September 1926. Under the contracts, Coliseum was to promote the fight. After the contracts were signed, Coliseum paid $10 to Dempsey and $300 to a stadium architect to design the layout of the ring. Subsequently, Coliseum entered into a third contract with Andrew Weisberg. Under the Weisberg contract, Weisberg was directed to help in the promotion of the fight, including securing accommodations for spectators and the arena. Weisberg was to incur the costs of this promotion and was to be reimbursed and paid from ticket sales from the fight. In July 1926, Coliseum sent Dempsey a letter asking him to submit to a pre-fight examination for insurance purposes. Dempsey responded that he was training for a different fight, against Gene Tunney, and that he would not be honoring the agreement with Coliseum. Coliseum also brought suit in an Illinois court for the following damages: (1) loss of profits; (2) expenses incurred prior to signing the agreement with Dempsey, meaning expenses incurred in signing the contract with Wills; (3) expenses incurred in attempting to stop Dempsey from fighting Tunney; and (4) expenses incurred after the Dempsey contract was signed, but before Dempsey's breach. Court held expenses incurred between signing and breach by defendant, as well as necessary expenses for performance, were recoverable; remainder claims were not. Speculative damages, costs incurred prior to contract, and costs incurred not specified in contract to force contract compliance were unrecoverable. Court permitted damages only for expenses incurred during time between signing of contract and defendant's repudiation of contract. After this certainty limitation of damages rule was established, another question come to our eye is to what extent evidence need to prove the certainty of loss of profit in order to have the court grant the damages to plaintiff. And the answer is no idea. On the opinion-writing level, the judge does not explain the intuitive processes that led her to the decision. Instead, she seeks authority that makes it seem the decision was a foregone conclusion. When lost profits are at issue, there is an abundance of authority to support whichever decision the judge makes. As explained below, there are many contradictory rules, and the opinion-writer can choose those that support her conclusion, making it seem the issue was never in doubt and often giving the impression that a single factor made the outcome inevitable. Commercial plan, market investigation, state of operation are reasonable evidences that can be listed to prove expected profits.