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CONSEQUENTIAL DAMAGES IN CONTRACT—THE POOR RELATION?

*Andrew Tettenborn**

While consequential damages have long been a part of contract law, the legal boundaries of such losses have not been well defined. In seeking to recreate a working definition for consequential damages in contract claims, this Article explores the actual differences between consequential and direct damages by looking at the application of remoteness, foreseeability, and proof-of-loss standards to these damage categories. Ultimately, this Article argues that damages for consequential loss in contract should be regarded as subject to substantially different rules from those applying to direct losses.

I. INTRODUCTION

When law professors talk about the various sorts of damages courts award for breach of contract and the function these damages serve, the discussion tends to center on a relatively small number of familiar issues. Scholars are spoilt for choice if they want to rake over such matters as expectation measures versus reliance measures,¹ why we allow expectation claims at all,² or at what point recovery of reliance losses is a genuine alternative to a claim for lost profits.³ But one topic tends to be forgotten, and that is consequential losses such as claims for personal injury, damage to property, or simple cash profits foregone as a result of a breach of contract. These are awkward. However much taken for granted, they cannot readily be shoehorned into the venerable expectation, reliance, and restitution

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1. Starting universally, if unoriginally, with L.L. Fuller & William R. Perdue, Jr., *The Reliance Interest in Contract Damages*, 46 *YALE L.J.* 52 (1937). But the literature is immense. A recent, more useful starting point is Richard Craswell, *Against Fuller and Perdue*, 67 *U. CHI. L. REV.* 99 (2000).

2. W. David Slawson, *Why Expectation Damages for Breach of Contract Must Be the Norm: A Refutation of the Fuller and Perdue "Three Interests" Thesis*, 81 *NEB. L. REV.* 839 (2003).

3. As in, for instance, Michael B. Kelly, *The Phantom Reliance Interest in Contracts Damages*, 1992 *WIS. L. REV.* 1755 (1992).

pigeonholes constructed in 1936,⁴ which still (though admittedly decreasingly)⁵ inform most discussion of contract damages.⁶ They are clearly not restitution. Furthermore, except in the trivial sense that the victim expected not to suffer them and doubtless relied on being free from them, consequential-losses claims do not have anything to do with either expectation or reliance.⁷ Instead they languish in the background like some elderly poor relative: everyone knows they are there, but no one knows them very well, and most people would prefer not to talk about them.

The thesis of this Article is that this sidelining of consequential losses is unfortunate and that the rules relating to them merit discussion just as much as those applicable to expectation or reliance losses.⁸ More importantly, this Article suggests, referring to both American and English authority, that consequential damages resulting from a breach of contract⁹ behave remarkably differently from other kinds of damages in a number of respects. It then goes on to suggest that a distinction between consequential and other losses is both intellectually justifiable and founded in good sense.

4. Fuller & Perdue, *supra* note 1, at 52.

5. See, e.g., Craswell, *supra* note 1, at 105–21. David W. Barnes & Deborah Zalesne, *A Unifying Theory of Contract Damage Rules*, 55 SYRACUSE L. REV. 495, 503 (2005), state the point more brutally: the distinction is simply “irrelevant to calculating damages for contract breaches.”

6. Interestingly, under the RESTATEMENT (SECOND) OF CONTRACTS § 344 (1981), the definition of the relevant interests is straight out of Fuller & Perdue, *supra* note 1. See also RESTATEMENT (SECOND) OF CONTRACTS §§ 347, 349 (1981) (“[T]he injured party has a right to damages based on his expectation interest As an alternative . . . the injured party has a right to damages based on his reliance interest.”). Most textbooks also at least start by recognizing the same scheme, though some (e.g., E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS § 12.8 (3d ed. 2004)) creditably refuse to be drawn in.

7. They appear, slightly grudgingly, as a footnote in the RESTATEMENT (SECOND) OF CONTRACTS § 347 cmt. c & illus. 4 (1981).

8. Not that this point is new. See, e.g., David W. Barnes, *The Net Expectation Interest in Contract Damages*, 48 EMORY L.J. 1137, 1149 (1999) (referring to a fourth interest which he calls the “curative interest”). This is much the same as what I refer to as consequential damages. See also Eric G. Anderson, *The Restoration Interest and Damages for Breach of Contract*, 53 MD. L. REV. 1, 13–14 (1994).

9. A similar argument can be made with respect to consequential damages under tort law; however, this Article will only address this argument under contract law.

II. WHAT ARE CONSEQUENTIAL LOSSES?

If we want to suggest that consequential losses are somehow special, we need to first know what we mean by them. This is not quite as easy as it sounds. In particular, although both the Uniform Commercial Code (“U.C.C.”)¹⁰ and the *Restatement (Second) of Contracts*¹¹ occasionally refer to consequential losses, neither regards the concept as a term of art nor places much emphasis on it. At times its boundaries seem remarkably uncertain.¹² As a result, this Article will leave these treatments aside and attempt to craft a new definition. Losses, it is suggested, should be regarded as consequential when they are plaintiff-specific, meaning, when their amount is dependent on the position or circumstances of the particular plaintiff.¹³ They are direct. If this is not the case, the measure of compensation is conventional or a function of the breach.¹⁴

A few concrete examples will make this point less abstract. Suppose Seller agrees to supply raw materials to Buyer for \$10,000 but fails to deliver them when they are worth \$12,000 in the market. Alternatively, suppose Carrier hired by Buyer to transport the same materials (again worth \$12,000) negligently loses them. Classifying these two claims, the \$2,000 difference against Seller in the first case

10. U.C.C. section 305(a) (2007) provides that “neither consequential or special nor penal damages may be had except as specifically provided in [the Uniform Commercial Code] or by other rule of law.” U.C.C. sections 2-710 and 2-715 then deal with the availability of incidental and consequential damages to buyers and sellers. For the meaning of these terms in this context, see Roy Ryden Anderson, *Incidental and Consequential Damages*, 7 J.L. & COM. 327, 364 (1987); Paul S. Turner, *Consequential Damages: Hadley v. Baxendale Under the Uniform Commercial Code*, 54 SMU L. REV. 655 (2001).

11. See RESTATEMENT (SECOND) OF CONTRACTS § 347 (1981) (where the victim of a contract breach is entitled to the value of performance, plus “any other loss, including incidental or consequential loss, caused by the breach . . .”).

12. For a brief discussion of the possible different meanings, see David W. Barnes & Deborah Zalesn, *The Shadow Code*, 56 S.C. L. REV. 93, 99 (2004).

13. This is not entirely new. It has some similarities to a distinction drawn at the beginning of the leading English text, HARVEY MCGREGOR, MCGREGOR ON DAMAGES §§ 1-035 to 1-040 (Sweet & Maxwell, 17th ed. 2003), between “normal” and financial losses, suffered in nearly all cases, and consequential ones, which are not.

14. This parallels the distinction drawn by some lawyers between general and other damages, as described in Roy Ryden Anderson, *Incidental and Consequential Damages*, *supra* note 10, at 328–29. But “general damages” is such a protean term on both sides of the Atlantic that I prefer not to use it here. For the various English meanings of “general damages” see, e.g., MCGREGOR *supra* note 13, §§ 1-029 to 1-036.

or the \$12,000 value claim against Carrier in the second, is straightforward. These damages must, on any score, be considered direct. The amount awarded is a function of the worth of the goods in the market. The damages are calculated in an abstract way from the value of which the plaintiff has been deprived. To put this point another way, the measure of these damages would be the same whoever the plaintiff was and whatever her circumstances may be.

Now, however, add in some additional losses. Suppose, that as a result of Seller's failure to deliver the materials, Buyer is deprived of the usual, foreseeable, and non-exorbitant \$5,000 profit she would have made from processing or reselling them. Additionally, suppose that she also fails to get further orders worth \$8,000 from third parties who now, no doubt with reason, mistrust her supply chain. What of these? On any reasoning, the \$8,000 loss must be consequential (if it is claimable at all, which it would not be absent fairly specific knowledge by Seller of Buyer's business arrangements). The \$5,000, generally recoverable even in the absence of special knowledge,¹⁵ is less easy to identify at first sight. For some purposes at least, it undoubtedly has been called direct,¹⁶ but for others (an obvious example being insurance),¹⁷ it is equally clearly categorized as consequential. On the other hand, if one applies the criterion of whether the quantification of the claim is breach-specific or plaintiff-specific, there is no doubt that it is consequential. There may be no lost profits at all, and even if there are, their amount is entirely dependent on the facts surrounding the plaintiff's business. For the same reason, damages for harm to a buyer's property or personal injury to the buyer herself caused by defective goods or botched services are always consequential.¹⁸

15. For example, under the common law rule in *Hadley v. Baxendale*, (1854) 156 Eng. Rep. 145 (Exch. Ct.), and more particularly under U.C.C. § 2-715(2) (2007).

16. In England, for example, liability for this loss would not be excluded by a clause restricting a contract-breaker's liability for consequential losses because such clauses are interpreted as inapplicable to foreseeable losses falling under the first limb of the *Hadley v. Baxendale* rule. New York similarly classifies damages as "direct" or "consequential" according to which limb of *Hadley* they fall under. *Roneker v. Kenworth Truck Co.*, 977 F.Supp. 237, 240 (W.D.N.Y. 1997). Many sections of the U.C.C. arguably do the same. See Paul S. Turner, *supra* note 10.

17. Since an ordinary indemnity policy would not pay it, it would be recoverable only if there were consequential-loss coverage.

18. U.C.C. § 2-715(2)(b) (2007).

Once again, whether they are suffered is a matter of the luck of the draw, depending on the circumstances of the individual plaintiff, particularly whether she has any property vulnerable to damage and so on.

The same distinction can, it is suggested, also be profitably applied to some less obvious cases of contract damages. Two instances in particular are important here. The first involves claims for the cost of rectifying defects in work done for the plaintiff. A straightforward example would be correcting or finishing construction operations that ought to have been done by the defendant but were not. The second involves damages for nonpecuniary loss given to a plaintiff deprived of benefits under a contract that was entered into with a clear emotional (or at least more than financial) rationale. Both of these cases raise difficulties. But, as I will argue below, if they are properly categorized—and, to anticipate, I will suggest that they are direct rather than consequential—many of these difficulties disappear.

III. THE DIFFERENCES BETWEEN DIRECT AND CONSEQUENTIAL LOSSES

At first sight it sounds odd to suggest that there is (or even should be) any difference, apart from the name, between direct and consequential losses. On the contrary, the modern tendency is to think of a party breaching a contract as being liable for the foreseeable loss resulting from his breach, no more and no less, without singling out any particular sort of loss for special treatment. Whatever contingent differences there may be, if a plaintiff can show that she is foreseeably less well-off than she would have been had the defendant not breached, that is it. It is beside the point to go on and ask whether the impoverishment happened directly, at one step removed, or at four.¹⁹

Life, however, is more untidy than that.²⁰ In practice, as will appear, it may well make a difference whether the harm the plaintiff

19. David W. Barnes & Deborah Zalesne, *A Unifying Theory of Contract Damage Rules*, 55 SYRACUSE L. REV. 495 (2005).

20. As is, for that matter, the idea of a “loss” in the first place. Cf. L.L. Fuller & William R. Perdue, Jr., *The Reliance Interest in Contract Damages*, 46 YALE L.J. 52, 53 (1937) (“[L]oss . . . is not a datum of nature but the reflection of a normative order.”); see also Andrew Tettenborn,

is complaining of is necessary and immediate, or contingent and consequential. Put shortly, the general rule is that as soon as a loss is categorized as consequential in the sense used in this Article, the plaintiff who seeks to recover it faces more hurdles than if it is not.

(a) *Remoteness.*

We may as well start with remoteness under the principle in *Hadley v. Baxendale*²¹ or any analogous foreseeability rule that applies. Admittedly, at first sight the difference between direct and consequential losses in this connection is not obvious. Insofar as there is such a difference (the argument runs), this can surely be explained on the basis that consequential losses are *ex hypothesi* less foreseeable than direct ones or by applying some analogous reasoning.²²

But the suggestion here is that this is not the whole story. We can, it is submitted, go further and say that to all intents and purposes, the remoteness rule is limited to consequential losses and does not apply at all to direct losses.²³ In particular, out of the thousands of cases where plaintiffs have found their damages limited by references to a doctrine of foreseeability, it is noteworthy that virtually all have involved claims for consequential losses in some

What Is a Loss? in EMERGING ISSUES IN TORT LAW 441, 441–66 (Jason W. Neyers et al. eds., 2007).

21. (1854) 156 Eng. Rep. 145 (Exch. Ct.).

22. For example, it could be said that direct measures such as the standard “value less price” figures in sale of goods cases count, by definition, as foreseeable. Thus, such direct measures count as damages arising naturally, i.e., according to the usual course of things, from such breach of contract, *id.* at 151, or damages following from the breach “in the ordinary course of events.” RESTATEMENT (SECOND) OF CONTRACTS § 351(2)(a) (1981). See also Anderson, *supra* note 10, at 338–39, 342 (suggesting that “[t]he nature of the damages, rather than the label attached to them, makes incidental damages more easily recoverable”). The same view has sometimes surfaced in England. See, e.g., *Interoffice Tels. Ltd. v. Robert Freeman Co.*, [1958] 1 Q.B. 190, 202 (suggesting that losses of profits through ordinary market movements should generally be regarded as foreseeable).

23. Such a conclusion is at least hinted at under U.C.C. § 2-715 (2007). Under that section, incidental damages available to a seller are defined without qualification. Consequential damages must be something “of which the seller at the time of contracting had reason to know. . . .” See generally Anderson, *supra* note 10, at 338 (explaining that the Code “states restrictions for the recovery of consequential damages which ostensibly do not apply to incidental damages”). It should be noted, however, that the correlation between incidental damages under the U.C.C. and direct damages in this Article is not exact.

form or another.²⁴ The forms of loss involved have of course been legion: lost sales, collapse of the plaintiff's business, long-tail lost profits, damage to property, personal injury, psychological trauma, or whatever. Nevertheless, what nearly always has been in issue is damage resulting not directly but collaterally from a particular breach, which is, to a greater or lesser extent, dependent on the plaintiff's particular situation.

Direct loss claims, by contrast, are treated rather differently. A number of examples illustrate the point. A disappointed buyer of goods can claim value less price,²⁵ and the disappointed seller vice versa.²⁶ The defaulting carrier or bailee is liable for the value of goods destroyed or the depreciation of goods damaged.²⁷ The property owner is entitled to the amount by which her property is devalued as a result of bad work.²⁸ But, however controversial these measures of recovery may be in other respects,²⁹ they are curiously unaffected by criteria of foreseeability. On the contrary, the plaintiff is generally able to recover them as a matter of course,³⁰ even if their extent is not foreseeable.³¹ True, one could say that this was simply a function of the rule that foreseeable damages are recoverable even if

24. Notably, the same is true of every single example given in section 351 of the RESTATEMENT (SECOND) OF CONTRACTS (1981), the "foreseeable loss" section.

25. U.C.C. § 2-713 (2007).

26. *Id.* § 2-708.

27. 25 SAMUEL WILLISTON & RICHARD A. LORD, WILLISTON ON CONTRACTS § 66:104 (4th ed. 2002).

28. RESTATEMENT (SECOND) OF CONTRACTS § 348(2)(a) (1981).

29. Particularly, where the actual circumstances of the plaintiff suggest a clear measure of financial loss, the issue is whether the plaintiff can choose to disregard the actual loss and sue for the notional one. Compare Henry Gabriel, *The Seller's Election of Remedies Under the Uniform Commercial Code: An Expectation Theory*, 23 WAKE FOREST L. REV. 429 (1988) (arguing that the seller should be allowed to elect between the two remedies regardless of the seller's good faith post-breach activities concerning the non-accepted goods) with Roy Ryden Anderson, *Damage Remedies Under the Emerging Article 2—An Essay Against Freedom*, 34 HOUS. L. REV. 1065, 1067 (1997) (arguing that damages remedies must be limited to compensating monetarily for the lost expectation of the injured party, "[t]hus, under article 2, an aggrieved party may not use a damage provision that would provide a supracompensatory recovery").

30. See U.C.C. § 2-715(1) (2007).

31. FARNSWORTH, *supra* note 6, at § 12.14 (liability for rise in market even if "startling and extreme"). The same applies in England to such direct claims. Cf. *Wroth v. Tyler*, [1974] Ch. 30 (illustrating that on the sale of a house, plaintiffs were entitled to damages including the rise of house prices since the date of breach).

the extent of damages are unforeseeably large.³² But this in turn raises difficulties. Despite the reiteration of the “foreseeable damages in an unforeseeable amount” rule, unforeseeably large consequential lost profit claims are regularly disallowed.³³ In short, it seems simpler to say that foreseeability does not form a serious barrier to claims for direct, as compared to consequential, loss.

The idea that the foreseeability rule is really a consequential damages doctrine may also explain another otherwise puzzling feature of remoteness—namely, the relation between remoteness in contract and remoteness in tort. The problem is that even though everyone regards it as obvious that *Hadley v. Baxendale* is a contract limit that does not apply in tort suits,³⁴ in many cases this is not true. Take, for example, a malpractice plaintiff claiming some loss allegedly consequent to the fault of her lawyer or accountant; it may be profits foregone, the loss of a business, or whatever. If she sues in contract, clearly the loss in respect of which she claims must be foreseeable as a fairly substantial possibility. But what is interesting is that the plaintiff cannot escape this rule by redesignating her suit as tortious. Even if the jurisdiction concerned allows clients to sue in either contract or tort,³⁵ the result is the same: her loss remains

32. FARNSWORTH, *supra* note 6, § 12.14, (“The magnitude of the loss need not have been foreseeable, and a party is not disadvantaged by its failure to disclose the profits that it expected to make from the contract.”); *see, e.g.*, *Barnard v. Compugraphic Corp.*, 667 P.2d 117 (Wash. App. Ct. 1983). Similarly in England, most recently, *see the House of Lords in Jackson v. Royal Bank of Scot.*, [2005] UKHL 3, [2005] 1 W.L.R. 377 (U.K.).

33. Thus, it is not hard to find statements that extraordinary or excessive profits are irrecoverable. *See* FARNSWORTH, *supra* note 6, at § 12.14 (seller not liable for lost profit “to the extent that it is extraordinary”); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 351 cmt. b, illus. 6 & 7 (1981). *Compare* *Coastal Int’l Trading Ltd. v. Maroil AG*, [1988] 1 Lloyd’s Rep. 92, 95 (Q.B.) (no profits recovery where “unusual terms as would render the plaintiffs’ profit . . . unreasonable”). Indeed, it is difficult to see the classic *Victoria Laundry (Windsor) Ltd. v. Newman Indus. Ltd.*, [1949] 2 K.B. 528 (U.K.) as doing much more than limiting profits on the basis that they are unforeseeably large.

34. Straightforward authorities are *Petition of Kinsman Transit Co.*, 338 F.2d 708, 724 (2d Cir. 1964) and *Koufos v. C. Czarnikow Ltd.*, [1969] 1 A.C. 350, 389–90 (H.L. 1967), both of which state explicitly that *Hadley v. Baxendale* has no part to play in tort suits.

35. England allows this, almost without limitation. *See* *Henderson v. Merrett Syndicates Ltd.*, [1995] 2 A.C. 145 (H.L.) (U.K.). The tendency in the United States is similar, though not as marked. *See, e.g.*, *Congregation of the Passion v. Touche Ross & Co.*, 636 N.E.2d 503 (Ill. 2004) (accountant); *Moransais v. Heathman*, 744 So. 2d 973 (Fla. 1999) (engineer); *Collins v. Reynard*, 607 N.E.2d 1185 (Ill. 1992) (lawyer); *Beachwalk Villas Condo Ass’n, Inc. v. Martin*, 406 S.E.2d 372, (S.C. 1991) (architect). *But see* *Rothberg v. Reichelt*, 705 N.Y.S.2d 115 (App. Div. 2000).

irrecoverable unless reasonably foreseeable.³⁶ But if so, how can this be reconciled with the acceptance that remoteness requirements in tort are much less exacting, with perceptible, if highly unlikely, risks still able to trigger liability? The answer, it is suggested, may well be that the direct-indirect distinction referred to above is quietly being applied across the contract-tort boundary. In contract, direct loss is generally obtainable, but consequential loss is recoverable only if clearly foreseeable. Just as in contract, so also in tort. Even if a very small degree of likelihood is enough to establish liability on principle, when it comes to recovering further consequential losses, a much greater likelihood has to be shown equivalent to the more exacting criterion of *Hadley v. Baxendale*.³⁷

(b) *Proof of Loss.*

We now turn to another area of potential difference between direct and consequential losses: the rules as to proof of loss. As with remoteness, at first sight this looks like fairly unrewarding territory. Surely the general rule is simple: a contract plaintiff, like any other, must prove her loss, and if she cannot do this, she recovers nothing (or, more accurately, only nominal damages). In fact, however, it is suggested that here too matters are more complex. In particular, there are indications that what counts as proof of loss varies according to the kind of loss in issue. To put it more provocatively, the traditional rules as to proof are, like the foreseeability rule, limited to consequential losses and do not apply in practice to direct ones.

Let us begin with an obvious example: market difference claims by buyers and sellers. We all know that in both the United States and England, a disappointed seller *prima facie* recovers price less

36. See the English decisions in *Banque Bruxelles Lambert SA v. Eagle Star Ins. Co. Ltd.*, [1995] Q.B. 375 (U.K.), and *Birmingham Midshires Building Society v. Phillips*, [1998] P.N.L.R. 468 (Ch.), referred to below. The indications are less clear in the United States, but compare the old New York case of *Kerr S.S. Co., Inc. v. Radio Corp. of America*, 157 N.E. 140 (N.Y. 1927) (even if there is concurrent liability in contract and tort, the *Hadley* rule applies to both claims for negligent failure to send telegraphic message).

37. I have developed this argument further elsewhere. See ANDREW TETTENBORN ET AL., *THE LAW OF DAMAGES* §§ 6.50–6.64 (2003); see also Andrew Tettenborn, *Hadley v. Baxendale: Contract Doctrine or Compensation Rule?*, 11 TEX. WESLEYAN L. REV. 505, 516–20. (2005).

value,³⁸ an aggrieved buyer recovers the converse differential,³⁹ and a receiver of defective goods recovers the value deficiency due to the defect.⁴⁰ However, what is striking is that the question of whether any of these figures actually does anything, apart from putting in a nominal appearance on the plaintiff's balance sheet or actually affecting her business, is regarded as curiously irrelevant. This is particularly true in England, where the relevant legislation⁴¹ is still (in effect) the same as the Uniform Sales Act drafted by Samuel Williston⁴² and thus continues⁴³ to embody the pretty inflexible common law prejudice in favor of market damages.⁴⁴ But it is also a fair summary of the position under the *U.C.C.* Admittedly, here, courts are more willing to take account of positive proof that the plaintiff's actual loss is less than market damages.⁴⁵ For example, a disappointed buyer who has actually covered for less than the market price cannot collect a windfall by suing for value less price.⁴⁶

38. This is provided for in legislation on both sides of the Atlantic. See *U.C.C.* § 2-708 (2007); *Sale of Goods Act*, 1979, s.50(3).

39. See *U.C.C.* § 2-713 (2007); *Sale of Goods Act*, 1979, s.51(3).

40. *U.C.C.* § 2-714 (2007); Roy Anderson, *Buyer's Damages for Breach in Regard to Accepted Goods*, 57 *MISS. L.J.* 317 (1987). For England, see *Sale of Goods Act*, 1979, s.53(3).

41. The *Sale of Goods Act*, 1979 (re-enacting, with astonishingly few changes, its namesake of 1893).

42. Now curiously forgotten, but reprinted in LAWRENCE VOLD, *HANDBOOK OF THE LAW OF SALES* app. at 507 (1931).

43. But even in England, the position may be changing. An interesting straw in the wind is *Bence Graphics International Ltd. v. Fasson UK Ltd.*, [1998] Q.B. 87 (U.K) (holding that a buyer of defective raw materials who successfully incorporated them in her product without complaint from customers could not rely on the English equivalent of *U.C.C.* § 2-714(2) (2007) and claim the difference in value).

44. The connection is neatly described in Robert E. Scott, *The Case for Market Damages: Revisiting the Lost Profits Puzzle*, 57 *U. CHI. L. REV.* 1155, 1161-62 (1990). The classic English cases, still generally accepted as good law, are *Rodocanachi, Sons & Co. v. Milburn Bros.* (1886) 18 Q.B.D. 67 and *Williams Bros. v. Agius Ltd.* [1914] A.C. 510 (the latter on the statutory English analog to *U.C.C.* § 2-713), both of which contradict the tendency of modern American authority by flatly ignoring matters that are clearly going to reduce loss).

45. See, e.g., *H-W-H Cattle Co. v. Schroeder*, 767 F.2d 437 (8th Cir. 1985) (corresponding to *U.C.C.* § 2-713 (2007)); *Nobs Chem., U.S.A., Inc. v. Koppers Co.*, 616 F.2d 212 (5th Cir. 1980) (corresponding to *U.C.C.* § 2-708 (2007)); *Alafoss v. Premium Corp. of Am.*, 599 F.2d 232 (8th Cir. 1979) (under *U.C.C.* § 2-714); *Allied Cannery & Packers, Inc. v. Victor Packing Co.*, 209 Cal. Rptr. 60 (Ct. App. 1984); *Vorthman v. Keith E. Myers Enters.*, 296 N.W.2d 772 (Iowa 1980). See generally Anderson, *supra* note 29, at 1065 (examining cases in which market damages overcompensate).

46. See *U.C.C.* § 2-713 cmt. 5 (2007); see also Anderson, *supra* note 29 at 1101 and authorities there cited.

Nevertheless, it remains accurate to say that market damages continue to act as a conventional valuation of the plaintiff's performance interest. Whatever the plaintiff's actual position is, market damages are recoverable unless there are clear indications that some particular other figure is more appropriate.⁴⁷ Now again, as with remoteness, this looks puzzling at first sight. It is all very well to have a doctrine of strict proof of loss, but why have one that covers some losses and not others? My suggestion, once again, is that what lies behind this otherwise difficult distinction is a difference between direct and consequential losses.

Market damages, particularly when dealing with generalized-commodity contracts, might be dismissed as a special case. It is suggested, however, that this particular point about proof of loss is much more general. Three possible extensions may be worth mentioning here, two of particular English relevance, and one of equal significance on both sides of the Atlantic.

The first, which has arisen in direct and troublesome form in England,⁴⁸ concerns a specialized type of lawsuit—namely, claims for badly constructed buildings. Typically, the scenario is as follows: A construction contractor employed by a client property owner (or one of its subcontractors) does a bad job. However, before the defects become apparent, the client sells the project to a buyer, to whom it simultaneously assigns its rights under the construction contract.⁴⁹ Later, when sued by the buyer for the cost of correcting the defect, the contractor pleads that the original client suffered no loss and the buyer, therefore, has no substantial claim either.⁵⁰ The English courts have had to find an answer to this plea, whose sheer

47. See, e.g., *Trans World Metals, Inc. v. Southwire Co.*, 769 F.2d 902, 908 (2d Cir. 1985) (corresponding to U.C.C. § 2-708 (2007)); *Tongish v. Thomas*, 840 P.2d 471, 475 (Kan. 1992); *Unlimited Equip. Lines, Inc. v. Graphic Arts Ctr., Inc.*, 889 S.W.2d 926 (Mo. Ct. App. 1994) (corresponding to U.C.C. § 2-713 (2007)). The last case is particularly instructive. There was very little indication of what the plaintiffs had actually stood to make out of the contract. The court held that a market award was mandated in the absence of clear proof of a particular alternative measure. *Unlimited Equip. Lines*, 889 S.W.2d at 941.

48. See *infra* notes 51–53 and accompanying text.

49. Typically this issue arises over shopping malls, which by English practice are constructed by real estate developers who then immediately sell to investors such as insurance corporations or pension funds. But it can arise elsewhere as well.

50. The buyer has no substantial claim because, on any orthodox analysis, the assignee of a right stands in the shoes of the assignor and cannot be in a better position than the latter was in.

logic is matched only by its moral and commercial demerit. Despite an occasional tendency to posit a bare-faced exception to either the rules on the need to prove loss⁵¹ or the rules of assignment,⁵² they have in at least three cases reached a more subtle conclusion—namely, that the provision of bad building services is regarded as causing a loss measured by the cost of rectifying the work.⁵³ Hence the wind is taken out of the defendant's sails at the outset.

Yet more interestingly for our purposes, it was suggested in one of these cases that this reasoning only applied to measures of damages measured by an “objective standard” and not to other damages such as loss of profits caused by delay.⁵⁴ This suggestion, which has common sense behind it, reproduces the distinction we have been drawing here between plaintiff-specific and non-plaintiff-specific damages. Once more, in the case of the latter but not the former, it seems to be increasingly accepted that the rules of proof of loss simply work in a different way.

Another memorable decision in England, incidentally mentioned once or twice in U.S. law review articles,⁵⁵ brings the issue out clearly in a slightly different context. In *Ruxley Electronics Ltd. v. Forsyth*,⁵⁶ a homeowner complained that his new swimming pool

51. The House of Lords was prepared to do just this in *Linden Gardens Trust Ltd. v. Lenesta Sludge Disposals Ltd.*, [1994] 1 A.C. 85 (H.L.). In this case they followed an enigmatic Scottish decision (*Dunlop v. Lambert*, (1839) 7 Eng. Rep. 824 (H.L.) (allowing a contractor in a few anomalous cases to sue for a loss suffered by someone else)). *Dunlop* is discussed in THE LAW OF DAMAGES §§ 3-46 to 3-48 (Andrew Tettenborn et al. eds., 2003). See also *Darlington Borough Council v. Wiltshier N. Ltd.*, [1995] 1 W.L.R. 68. Where the claim is in tort for latent damage to property, the House in a Scottish appeal was once again prepared to introduce an exception to ensure justice was done. *G.U.S. Prop. Mgmt. Ltd. v. Littlewoods Mail Order Stores Ltd.*, [1982] S.L.T. 533 (H.L.).

52. This occurred in *Offer-Hoar v. Larkstore Ltd.* [2006] 1 W.L.R. 2926 (Eng.), where the Court of Appeal blithely punched a hole in the rule that the assignee could do no better than the assignor by holding that the assignee had the rights the assignor would have had if there *had been no sale and thus no assignment*.

53. See *Alfred McAlpine Constr. Ltd. v. Panatown Ltd.*, [2001] 1 A.C. 518, 545-46, 587-88 (H.L. 2000) (appeal taken from Eng.) (Lord Millett); *Linden Gardens Trust Ltd. v. Lenesta Sludge Disposals Ltd.*, [1994] 1 A.C. 85, 96 (H.L. 1993) (appeal taken from Eng. and Wales) (Lord Griffiths); *Darlington Borough Council v. Wiltshier N. Ltd.*, [1995] 1 W.L.R. 68 (Steyn, L.J.). It must be admitted that two other members of the House were less enthusiastic. See *Alfred McAlpine Constr. Ltd.*, 1 A.C. at 533-34, 570-71 (Lord Clyde and Lord Jauncey).

54. See *Alfred McAlpine Constr. Ltd.*, 1 A.C. at 554 (Lord Goff).

55. See Melvin A. Eisenberg, *The Disgorgement Interest in Contract Law*, 105 MICH. L. REV. 559, 595 (2006); Tony Weir, *All or Nothing?*, 78 TUL. L. REV. 511, 535 (2004).

56. [1996] A.C. 344 (H.L. 1995) (appeal taken from Eng.) (U.K.).

was built a few inches too shallow but candidly admitted that he had suffered neither a penny piece of money loss nor any appreciable inconvenience. The court nevertheless awarded him £2,500, and the House of Lords (having understandably denied him the cost of digging out the pool as both unintended and wholly disproportionate)⁵⁷ upheld the judgment. One judge in particular made the reason for this abundantly clear. This sum, he said, was justified as made simply on account of, and to mark, the denial of the homeowners's nonpecuniary interests.⁵⁸ Reading between the lines, what is envisaged here is an award for direct, non-plaintiff-specific loss, made without regard for the requirements of proof that obtain elsewhere in the law of damages. This is indeed the only sensible interpretation; were we to regard it as an award for some consequential loss, we immediately come up against the point that no consequences of any kind were alleged, much less proved.⁵⁹

A third type of case represents a problem familiar on both sides of the Atlantic. This is where the victim of a breach of contract claims a non-pecuniary loss. Now, the instinctive assumption here is that a plaintiff seeking damages of this type is effectively alleging a discrete (that is, in our sense, consequential) result of some wrong. A plaintiff disappointed in a costly but grimly joyless vacation, distraught when incompetent attorneys leave her subject to harassment by unwelcome admirers, or incandescent at builders who fail to construct according to orders is on this argument no different from a plaintiff complaining of a painful broken leg resulting from a traffic accident or rotted floorboard. The only distinction is that her injury takes a different, less tangible form. Hence the common view

57. To this extent, in reproducing the notorious *Peevyhouse v. Garland Coal & Mining Co.*, 382 P.2d 109 (Okla. 1962), where the lessee failed to perform a provision of a lease requiring the lessee, at the end of the lease, to perform remedial work, which would have cost an estimated \$29,000 but which would have increased the value of the farm of the lessors' farm only \$300. The relative economic benefit rule, rather than cost performance rule, was applicable, and the lessors could recover only \$300.

58. See *Ruxley Elecs. Ltd. v. Forsyth*, [1996] A.C. 344, 361 (H.L.) (appeal taken from Eng.) (Lord Mustill). Lord Bridge seems to have had similar ideas. See *id.* at 353 (Lord Bridge).

59. It is worth noting that a later case, also in the House of Lords, lends some support to this. In *Rees v. Darlington Memorial Hospital NHS Trust*, (2004) 1 A.C. 309 (H.L.) (appeal taken from Eng.), a similar non-plaintiff-specific award was made in another context. Explicitly not dependent on proof of loss, the award was made to the victim of a failed sterilization to mark (but not to compensate) the fact that the plaintiff now had an unwanted child.

that the proper criterion of whether such damages can be had is to ask whether the contract was one to provide excitement (or the lack of it)⁶⁰ or a *Hadley v. Baxendale*-style enquiry as to whether such mental suffering was foreseeable.⁶¹

But this analysis raises one substantial difficulty. plaintiff claiming damages for a broken leg must prove her affectation, and if she cannot do so, she gets nothing. By contrast, deciding whether a plaintiff has proved some supposed nonpecuniary loss such as distress or harassment would seem practically impossible, and certainly there seems little evidence that plaintiffs are seriously expected to do so. Nor, conversely, is there much indication that a defendant is allowed to reduce his exposure by alleging that the plaintiff was either unusually phlegmatic or indeed not really unhappy at all.⁶²

This is, to say the least, troublesome. On the other hand, most of the problems disappear if we re-categorize such awards as not having anything to do with consequential recovery at all. Insofar as a contract protects and, in the case of breach, allows compensation of nonpecuniary interests, the better approach is to say that the compensation is conventional and non-plaintiff-specific. This would be done in the same way as price-less-value damages and similar awards in sales of goods or damages under the principle in *Ruxley v. Forsyth* mentioned above. If this view is accepted, then the fact that the plaintiff cannot actually prove tangible distress or indeed any

60. For U.S. examples, see *Jankowski v. Mazzotta*, 152 N.W.2d 49 (Mich. Ct. App. 1967); FARNSWORTH, *supra* note 6, at § 12.17. For England, see, e.g., *Jarvis v. Swan's Tours Ltd.*, [1973] Q.B. 233; *Farley v. Skinner* [2001] UKHL 49, [2002] 2 A.C. 732 (appeal taken from Eng.); *Hamilton-Jones v. David & Snape*, [2003] EWHC 3147 (Ch), [2004] 1 W.L.R. 924.

61. Some U.S. courts have taken this line. See, e.g., *Lane v. KinderCare Ctrs., Inc.*, 588 N.W.2d 715 (Mich. Ct. App. 1998). In *Lane*, a child was negligently left locked in a daycare nursery when her caretakers went home, and damages were awarded for distress suffered by the mother on the basis that non-commercial contracts were within *Hadley v. Baxendale* criteria. *Id.*; *Groh v. Broadland Builders, Inc.*, 327 N.W.2d 443, 445 (Mich. Ct. App. 1982) (breach of a residential construction contract); *Fogleman v. Peruvian Assocs.*, 622 P.2d 63, 65 (1980) (Ariz. Ct. App. 1980) (wrongful firing). The "casket cases" are often decided on the same basis. See, e.g., *Lamm v. Shingleton*, 55 S.E.2d 810 (N.C. 1949). Some courts add a further requirement that the breach be willful and wanton. See, e.g., *Giampapa v. Am. Family Mut. Ins. Co.*, 64 P.3d 230 (Colo. 2003); see also Douglas J. Whaley, *Paying for the Agony: The Recovery of Emotional Distress Damages in Contract Actions*, 26 SUFFOLK U. L. REV. 935 (1992).

62. Though there is at least one maverick Canadian decision, *Cringle v. N. Union Ins. Co.*, (1981) 124 D.L.R. 3d 22 (Can.), which refused such damages partly on the ground of no proved actual distress.

particular affectation becomes irrelevant, and the availability of nonpecuniary awards slides neatly into place.

IV. CONSEQUENTIAL DAMAGES OUGHT TO BE DIFFERENT

So far I have discussed a number of ways in which consequential damages seem to be treated differently in practice from other kinds of damages. But now for the question of principle: should they be regarded differently, or is this treatment simply an illogical affectation that a mature legal system ought to do its best to get rid of?

The argument for this latter point of view is not difficult to see. It is an inherently attractive and certainly simple view that on principle, a contract-damages plaintiff should be entitled to recover her loss, no more and no less. Even if this loss is made up of separate components corresponding to direct losses and consequential losses following from the breach, there is no reason to regard this separation as anything more than a fact of legal life or as a matter justifying any difference in treatment. Loss, after all, is loss. Either the plaintiff should be allowed to recover it, or she should not (e.g., because it is too remote or because she has failed to mitigate her damages or for a host of other reasons). In any case the nature or provenance of the damages she is claiming should be beside the point. Nevertheless, it is suggested that however attractive at first sight, the suggestion that different kinds of losses should not be distinguished becomes less convincing as one looks closer at it.

To begin with, it is worth making the point that the identification of all damages into a single category of "loss" is a habit somewhat peculiar to contract lawyers. Once we move outside contract into tort (where an exactly parallel argument can be made that the plaintiff's fundamental entitlement should be to recover her "loss," pure and simple), there has never been any particular difficulty with separating direct or standardized damages from consequential, plaintiff-dependent ones. Property torts are a straightforward example. If an item of property is damaged, destroyed, or converted, the owner receives its depreciation or value as the case may be. We do not go further and ask what "actual" or pocket-book loss she has suffered. Nor do we worry about the fact that she might have sold

the asset for full value, or would have given it away the next day.⁶³ It is only where the plaintiff seeks to go further and recover consequential losses that we require losses to be proved with specificity.⁶⁴

Second, the idea that consequential damages ought to be treated on par with direct losses depends on the assumption that the two claims are of equal moral strength or, to put it another way, on the assumption that a right to claim damages for a breach of contract must logically extend to consequential losses.⁶⁵ But the truth of this assumption is by no means obvious. The recovery of consequential damages is not in any way inherent in the idea of damages as a substitute for contractual performance. For example, suppose *A* agrees to provide *B* with goods or services, such as soybeans or web-hosting services. *B*'s entitlement in such a case is therefore an entitlement to soybeans or web hosting; this is what the contract provides, no more and no less. Now assume the promised benefit is not forthcoming. If *B* instead receives her money value from *A*, then it is perfectly plausible to argue that given that all damages in the nature of things have to be reduced to money payments, she has now received all she deserves. *B* has the money equivalent of what *A* ought to have received in specie. It is undoubtedly true that *B* may have suffered further losses as well, and for that matter foreseeable ones. But it does not follow that the avoidance of these losses formed part of *B*'s entitlement. *A* never expressly promised that *B*

63. See RESTATEMENT (SECOND) OF TORTS § 927 (1979) (providing for the "market value" measure of damages for conversion or destruction). Additionally, the comments to section 927 make it clear that this measure of damages may well exceed the plaintiff's actual loss. See, e.g., *id.* at illus. 4. Typical English authorities include *The Charlotte* [1908] P. 206 (U.K.) (involving destruction of property in which plaintiff recovered in full even though property was at risk of third party who paid plaintiff for it) and *Kuwait Airways Corp. v. Iraqi Airways Co.*, [2002] UKHL 19 (appeal taken from Eng.) (U.K.) (involving conversion claim in which plaintiff recovered full value despite clear evidence that others would later have deprived plaintiff of same property in any event).

64. A neat English example, in contrast to the cases in the previous note, is *Dimond v. Lovell*, [2002] 1 A.C. 384 (H.L.) (appeal taken from Eng.) (refusing damages for loss of use of car where plaintiff rented a substitute but then invoked technical consumer credit defense and avoided having to pay the rental).

65. The pervasive assumption that liability for loss automatically means liability for consequential loss is astonishingly unarticulated. For a brief discussion of it in the context of torts, see Andrew Tettenborn, *Property Damage and Economic Loss*, 34 C.L.W.R. 128, 136–37 (2005).

would not suffer them. We may of course extend *A*'s obligation to make him compensate *B* for the further losses she has suffered and for good reason. For example, one might well think that business benefits from the extra security this grants to a plaintiff's expectations. But there is nothing necessary in this process. Indeed, there would be nothing illogical or incoherent about a legal system that merely awarded direct losses for breach of contract and excluded all consequences from compensation.⁶⁶

Of course hardly anyone seriously argues that liability for consequences should be entirely excluded from contract damages. To an extent, we accept that at least sometimes contract law should value not only strict entitlements but expectations as well. This is, moreover, understandable since everyone knows that people actually do contract with some end in mind apart from simply receiving the contract performance *tout court*. It also makes commercial sense that at least some of those expectations should be made good in damages if proper performance is not forthcoming. But this does not mean that all expectations (or even all foreseeable ones) should be protected. On the contrary, some are more worth protecting than others. In other words, there is every reason to limit or exclude liability for some consequences (exemplified by many building contractors who exclude liability for consequential losses in many of their contractual relationships).

One such case concerns proportionality. It makes good sense to protect a plaintiff's expectations where they are closely connected with, and proportionate to, the contractual performance itself (an obvious example being resale profits whose prospect is clearly made known to a seller). But the moral—and commercial—case weakens considerably where those expectations are entirely disproportionate to what was bought. Take the example of a farmer who orders a small but vital part for a harvester from the only supplier. If the part is not delivered, the supplier is obviously in breach. However, it is by no means obvious that he should, for that reason alone, be liable

66. This approach is not quite as outlandish as it seems. Robert E. Scott & George G. Triantis, *Embedded Options and the Case Against Compensation in Contract Law*, 104 COLUM. L. REV. 1428, 1453–55 (2004) comes close to adopting this approach regarding contracts as importing an option not to perform on paying one's co-contractor the value of the putative performance.

for the farmer's whole lost harvest resulting from his inability to use the harvester, even if he knew (which he probably did) that the loss might be in prospect. Indeed, the problematic nature of cases of this sort has been recognized to some extent in the United States, where the *Restatement (Second) of Contracts* accepted,⁶⁷ and the *U.C.C.* revision nearly provided,⁶⁸ that just some limitation was in order.

Another convincing reason to treat consequential liability with some care, and certainly not as giving rise to liability as a matter of course, comes from the need to have close regard to the nature of the obligation undertaken by the defendant. Even if it is accepted that there should be some liability for direct losses, it does not necessarily follow that other consequential liability should follow as of course. In tort, this is regarded as elementary; different torts provide recovery for different kinds of loss. A libel claimant seeking damages for personal injury or other nonreputational loss, for example, faces considerable difficulties;⁶⁹ so also, because of the economic loss rule, does a plaintiff claiming business losses from a defendant who negligently damages someone else's thing.⁷⁰ The defendant's duty—of care or otherwise—simply does not extend to losses of that sort. Insofar as the plaintiff seeks compensation, he is met with a plea of “no breach.”

In contract, the matter is not as easy because a contract is either kept or not, and if it is not, the defendant then is ipso facto in breach. Nevertheless, there are good reasons for applying a similar rule here and not simply saying that the defendant is liable for all foreseeable

67. See the enigmatic RESTATEMENT (SECOND) OF CONTRACTS § 351(3) (1981) (specifically permitting a court to disallow even foreseeable loss “if it concludes that in the circumstances justice so requires in order to avoid disproportionate compensation”); see generally M. N. Kniffin, *A Newly Identified Contract Unconscionability: Unconscionability of Remedy*, 63 NOTRE DAME L. REV. 247 (1988) (addressing whether, under certain circumstances, it may be fairer to impose some limit on foreseeable contract damages).

68. See Larry T. Garvin, *Disproportionality and the Law of Consequential Damages: Default Theory and Cognitive Reality*, 59 OHIO ST. L.J. 339 (1998).

69. Authority is split on both sides of the Atlantic. See M.C. Dransfield, Annotation, *Mental or Physical Suffering as Element of Damages for Libel or Slander*, 90 A.L.R. 1175 (1934), and the more positive RESTATEMENT (SECOND) OF TORTS § 623 (1977). For English examples, see MCGREGOR, *supra* note 13, at § 39-030; ANDREW TETTENBORN ET AL, *THE LAW OF DAMAGES* §§ 18.30-18.31 (2003).

70. See, e.g., *Robins Dry Dock & Repair Co. v. Flint*, 275 U.S. 303 (1927); *The Mineral Transporter*, [1985] 2 All E.R. 935 (P.C.) (appeal taken from N.S.W.).

loss. A series of English malpractice cases⁷¹ makes the point clear. For example, a real estate valuer overvalues security for a secured lender. If the borrower fails and the security is sold at a loss to the lender, the valuer is liable for the amount of the valuation but not for further losses caused by a property meltdown, even if (a) those losses would not have happened but for the loan and (b) the meltdown was clearly on the cards at the time the contract was made.⁷² The duty of the valuer was to value the security at the time of lending. While the valuer should clearly be liable for the amount of overvaluation at that time, subsequent depreciation is rightly regarded as outside the scope of its duty. Similarly, lawyers who misadvise real estate buyers of defects in title such as unexpected easements are not liable for other losses suffered by the buyers on the transaction,⁷³ and neither are corporate accountants who misaudit a corporation in the group liable for losses caused by further intragroup lending.⁷⁴ However foreseeable these further losses, they are not within the ambit of the duty undertaken by the defendant. Once again, the fact that particular loss happens to be consequential is an important factor in the determination that it ought to be treated differently.

V. CONCLUSION

This is a short Article, designed to make a short point. Its argument is simply this: that damages for consequential loss in contract are, and ought to be, regarded as different from damages for direct losses. They are in fact subject to different rules and rightly so. This is a fact that ought to be recognized in contracts scholarship. One can only hope that in future years as much will be written about them as a category as about other categories such as expectation, reliance, and other losses.

71. There is the occasional flicker of a similar fire in the United States. See *First Fed. S & L Ass'n v. Charter Appraisal Co.*, 724 A.2d 497 (Conn. 1999).

72. See the seminal decision of the House of Lords in *S. Austl. Asset Mgmt. Corp. v. York Montague Ltd.*, [1997] A.C. 191. It is discussed in CLERK & LINDSELL ON TORTS §§ 10-138, 10-167, 10-168 (19th ed. 2006).

73. See *Lloyds Bank Plc v. Crosse & Crosse* [2001] Lloyd's Rep. P.N. 452 (Court of Appeal.).

74. See *Galoo Ltd. v. Bright Grahame Murray* [1995] 1 All E.R. 16 (Eng.). See also *Bank of Credit & Commerce Int'l v. Price Waterhouse*, [1997] 4 All E.R. 781 (Ch.).

