CONTRACT DAMAGES

This book is a collection of essays examining the remedy of contract damages in the common law and under the international contract law instruments such as the Vienna Convention on Contracts for the International Sales of Goods and the UNIDROIT Principles of International Commercial Contracts. The essays, written by leading experts in the area, raise important and topical issues relating to the law of contract damages from both theoretical and practical perspectives. The book aims to inform readers of current developments, problems, trends and debates surrounding contract damages and reflects an ongoing dialogue on damages among representatives of common law, civil law, mixed and transnational legal systems. The general issues addressed in the collection include the purpose and scope of damages, the measures of damages, recoverability of losses, methods of limiting damages and assessment of damages. A special emphasis is placed on the examination of the role of gain-based damages, the meaning and definition of loss, the recoverability of damages for injury to business reputation, the recoverability of legal fees, the rules of mitigation and foreseeability, the dilemma between 'abstract' and 'concrete' approaches to the calculation of damages, and the relationship between changes in monetary value and the assessment of damages.

Contract Damages

Domestic and International Perspectives

Edited by
Djakhongir Saidov and Ralph Cunnington

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Foreword

This collection of essays is one result of a conference in June 2007 in Birmingham University's attractive Business School, part of which I had the pleasure of chairing. Their focus is on a traditionally somewhat neglected field, but one of domestic and international significance to which increasing attention has rightly been addressed in recent years.

The essays take damages in the widest (perhaps even controversial) sense of the word, with a number of papers tackling the border territory where 'restitutionary damages' may represent an alternative to reliance and expectation measures. This is territory where, since the House of Lords' decision in *Attorney General v Blake* in 2000, no practitioner can afford to be lost. But the maps are still being written, with academic assistance playing an invaluable role. The courts will for some time be engaged in implementing Lord Steyn's injunction in *Blake* to hammer out 'on the anvil of concrete cases' exceptions to the general principle that there is no remedy for disgorgement of profits in cases of breach of contract.

The whole collection includes essays by a range of distinguished experts which address not only the philosophical underpinning of the law of damages, but also more specifically topics such as the UN Convention on the International Sale of Goods and UNIDROIT principles. Together, these essays represent a valuable, informative and stimulating body of material, for both study and reference. The organisers, Djakhongir Saidov and Ralph Cunnington, are to be congratulated for arranging the conference and marshalling, as a result, a most interesting set of contributions to learning in this important field.

Lord Mance of Frognal

Contents

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Table of Cases

English law

Australian law

Canadian law

French law

German law

Italian law

New Zealand law

Swedish law

United States law

CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS (CISG)

Argentina

Australia

Austria

Belgium

Finland

France

Germany

Italy

Switzerland

United States

CONVENTION RELATING TO A UNIFORM LAW ON THE INTERNATIONAL SALE OF GOODS (ULIS)

Germany

Israel

INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES (ICSID)

Table of National Legislation and International Instruments

NATIONAL LEGISLATION

Belgium

Canada

Commonwealth of Independent States

France

Germany

Italy

Netherlands

Russian Federation

Switzerland

United Kingdom

United States

INTERNATIONAL INSTRUMENTS

Current Themes in the Law of Contract Damages: Introductory Remarks

DJAKHONGIR SAIDOV AND RALPH CUNNINGTON

I INTRODUCTION

The law of contract damages continues to fascinate and interest lawyers throughout the common and civil law world. The reasons for this are plenty, but perhaps three in particular stand out. First, much of the interest stems from the close connection between the law of damages and the wider policies and purposes pursued by the law of contract. In this respect, we would agree with Professor Farnsworth who argued that:

> [n]o aspect of a system of contract law is more revealing of its underlying assumptions than is the law that prescribes the relief available for breach.[1]

The better we understand the law of contract damages, the better we understand the policies and values that underlie the law of contract itself. Secondly, it is clear that the existence of remedies and, in particular, damages is vital for the effective operation of contract law. Without effective remedies,[2] the law of contract would lose much of its force and value,[3] and the market economy, which it aims to support and facilitate,[4]

1 EA Farnsworth, 'Damages and Specific Relief' (1979) 27 *American Journal of Comparative Law* 247.

2 Professor Coote makes the important point that contractual obligations are legal obligations only to the extent that they are enforced by the law: B Coote, 'Contractual Damages, *Ruxley*, and the Performance Interest' [1997] *CLJ* 537, 541. See also F Dawson, 'Reflections on Certain Aspects of the Law of Damages for Breach of Contract' (1995) 9 *Journal of Contract Law* 125, 125–6.

3 See, eg AL Corbin, *Corbin on Contracts: A Comprehensive Treatise on the Working Rules of Contract Law* (2002) 2.

4 H Collins, *The Law of Contract* (London, Butterworths, 4th edn, 2003) 9; J Jackson, 'Global Economics and International Economic Law' (1998) 1 *Journal of International Economic Law* 1, 5; A Rosett, 'Unification, Harmonization, Restatement, Codification, and Reform in International Commercial Law' (1992) 40 *American Journal of Comparative Law* 683.

would be substantially undermined. Thirdly, in the context of commercial contracts, there can be little doubt that damages are the most commonly claimed remedy. This is due, in part, to the common law's position that damages are the primary remedy for breach of contract. But there is another, more general, reason for the primacy of damages that applies to civil law jurisdictions as well. Because commercial people are predominantly concerned with pecuniary matters they want to achieve the end results in monetary terms. For that reason, the monetary remedy of damages will usually be their remedy of choice.

In recent years, the challenge to understanding contract damages has increased significantly with the emergence and development of the law of international instruments such as the Convention on Contracts for the International Sale of Goods (CISG),[5] the UNIDROIT Principles of International Commercial Contracts (UPICC)[6] and the Principles of European Contract Law (PECL).[7] These instruments pursue the goal of harmonising (and, to some extent, unifying) sales and contract law at the international and, in the case of the PECL, regional levels. This goal adds complexity to the analysis of contract damages in the context of these instruments, as lawyers now have to consider the importance and relevance of additional factors and values which might not have been relevant to a discussion of contract damages in the context of domestic legal systems.

This book aims to contribute to the continuing discourse in this area of the law. The chapters are based on papers presented and discussed at the Contract Damages: Domestic and International Perspectives conference held at the University of Birmingham in June 2007. The essays reflect the central themes of the conference: the purpose and scope of damages, the measure of damages, issues of recoverability, the methods of limiting damages and the assessment of damages. Many of the chapters integrate an analysis of the common law position with a discussion from the perspective of the international contract law instruments. This reflects the contributors' conviction that, in an increasingly globalised world, lawyers should be ready and willing to learn from the experiences of other legal systems.

In the remainder of this introductory chapter we do not intend to follow the structure of the book (as many such essays tend to do) but instead focus on three themes that dominated discussion at the conference. In so doing, it is hoped that we will provide the reader with an insight into the discussion and debate that took place at the conference and enable the reader to see how the essays contained herein engage with that debate.

[5] Available at http://www.cisg.law.pace.edu/cisg/text/cisg-toc.html (accessed 27 June 2007).

[6] Available at http://www.unidroit.org/english/principles/contracts/principles2004/blackletter2004.pdf (accessed 27 June 2007).

[7] O Lando and H Beale, *The Principles of European Contract Law* (The Hague, Kluwer, 2000).

II THE MERITS OF A COMPARATIVE APPROACH

A General

Although a substantial emphasis in this volume is placed on contract damages in the common law and under the international instruments, it is fair to say that the volume reflects an ongoing dialogue on contract damages by representatives of different legal systems and there is little doubt that its scope is truly comparative. We believe that, in an age characterised by the globalisation of commerce and markets and arguably by a gradual 'transnationalisation' of commercial law,[8] a comparative approach is not only beneficial but also necessary. The benefits associated with a comparative method are well known[9] and this is not a place to set them out fully. What we aim to do in this section is to highlight the importance and some possible merits of a comparative approach to the extent that they have special relevance to contract damages and the volume's scope.

B The Benefits of a Comparative Approach for the International Instruments

While it is true that the starting point for any comparative exercise is to generate and disseminate knowledge,[10] such an exercise will almost inevitably result in great practical benefits and will possibly lead to further legal development. Examining the experiences of different legal systems in the area of contract damages helps, in our view, to identify problems, questions and difficult factual situations that may arise and hence require treatment in any legal system. A comparative exercise will also provide a range of possible solutions to a particular problem, thereby broadening horizons for a lawmaker, a judge, a practitioner or a scholar. These potential benefits are particularly important so far as the international instruments are concerned. One reason is that neither the CISG nor the UPICC and PECL have yet had a degree of exposure and strength of experience comparable to those of well-developed legal systems. The CISG, for example, is often regarded as a 'skeleton' or a minimalist instrument[11] and, for such a legal

[8] See, eg KP Berger, 'Transnational Commercial Law in the Age of Globalization', available at http://w3.uniroma1.it/idc/centro/publications/42berger.pdf (accessed 27 June 2007).

[9] For a helpful introduction containing extracts and references to relevant sources, see R Goode, H Kronke and E McKendrick, *Transnational Commercial Law: Text, Cases, and Materials* (Oxford University Press, 2007) 133–89.

[10] K Zweigert and H Kötz, *An Introduction to Comparative Law* (Oxford, Clarendon Press, 3rd edn, 1998) 15.

[11] See, eg JS Ziegel, 'The Remedial Provisions in the Vienna Sales Convention: Some Common Law Perspectives' in N Galston and H Smit (eds), *International Sales: The United Nations Convention on Contracts for the International Sale of Goods* (New York, Matthew Bender,

regime, knowledge of a range of problems and factual situations, which have not yet arisen but may potentially arise, will prove invaluable. Ingeborg Schwenzer and Pascal Hachem[12] also make an important point in their chapter by stating that the modern age has brought about a number of new challenges, both in law and outside of it, which cannot go unnoticed when the CISG is applied. In fact, the authors' point sends quite an alarming message:

> If [the CISG] does not respond to current demands and continues to focus on the state of discussion prevalent in the 1970s (or more accurately the nineteenth century), it risks falling back into obscurity. The necessary adjustments will then be made by the concurrent application of domestic remedies to precisely those cases for which the CISG was originally designed. The battle for uniformity fought by the CISG would be lost.

C The Knowledge of Factual Situations and the Complexity of Modern Transactions

To return to our point about the importance of being aware of a range of possible factual situations, we believe that such awareness plays an essential role in our understanding of the law of damages. As Michael Bridge states,[13] it is impossible to find 'the law on damages in the text of statutory rules', and for this reason we believe that a true knowledge of this area of law can only derive from a clear understanding of the complexity and variety of problems surrounding modern commercial transactions. This may also partly explain the prominent role played by the English commercial law today which, thanks to its long tradition and a well-developed culture of the reliance on judicial precedent, has accumulated a substantial body of case law from which commercial spirit and the intricacies of commercial life emanate. It is important, however, not to be blinded by the experience and relative successes of a particular system as legal development has often been driven by the movement of ideas from one system to another and, in our view, legal systems should exist in the atmosphere of mutual enrichment. Some of the contributions to this volume do provide relevant examples in this respect. Thus, Franco Ferrari traces the origin of the well-known 'foreseeability rule' and demonstrates that its establishment in the common law through the English case of

1984) 9–4; J Felemegas, 'Introduction' in *An International Approach to the United Nations Convention on Contracts for the International Sale of Goods (1980) as Uniform Sales Law* (Cambridge University Press, 2007) (with further reference to Albert Kritzer), available at http://www. cisg.law.pace.edu/cisg/biblio/felemegas14.html (accessed 18 October 2007).

12 See I Schwenzer and P Hachem, 'The Scope of the CISG Provisions on Damages', this volume.

13 See M Bridge, 'The Market Rule of Damages Assessment', this volume.

Hadley v Baxendale[14] has roots in the civil law.[15] Alexander Komarov,[16] in turn, while also pointing out the civil law origin of the rule, states that the common law has been more successful than the civil law in developing this rule, largely due, once again, to a developed tradition of relying on case law.

The complexity and diversity of modern commercial practices and transactions, referred to in the previous paragraph, also make it necessary for lawyers to go beyond a legal discipline and to get acquainted with, and learn from, developments in other disciplines and sciences. This point is made by Komarov, who, from the standpoint of his experience in commercial practice, argues that the reliance on general rules of damages, many of which were formed in domestic legal systems a long time ago, may no longer be adequate against the background of modern commercial practices, sophisticated transactions and the 'complex mathematical formulae used by economists in providing their calculation of damages'. Djakhongir Saidov's contribution[17] has attempted to do just that, by taking account of modern developments, both within and outside of the law, insofar as they can be relevant for measuring damages for injury to business reputation and goodwill.

D The Role of the International Instruments

Returning to the role played by the international instruments, despite the remarks made earlier about their possible lack of experience as compared with some more developed domestic counterparts, there is no doubt that the instruments deserve the most serious attention and examination. There are many reasons for this. First, the CISG has now been ratified by 70 states[18] and its rules arguably represent an international consensus as to what rules should govern international sales transactions. Similarly, the UPICC not only contain rules which are common to many legal systems,

[14] (1854) 9 Ex 341.

[15] Professor Ferrari's contribution is not only concerned with the origin of the rule. His central argument is that, while in cases where the Convention's drafters intended a particular concept to be interpreted from the standpoint of its counterpart in a domestic legal system, resorting to the 'domestic' understanding of the concept should be allowed in interpreting the CISG; however, the foreseeability rule in Art 74 is no such rule. He suggests that 'the mere fact that the wording of a particular CISG provision corresponds to that of a specific domestic rule (whether created by statute or case law) is *per se* insufficient to allow resorting to the interpretation of that domestic rule' (F Ferrari, '*Hadley v Baxendale* v Foreseeability under Article 74 CISG', this volume).

[16] See A Komarov, 'The Limitation of Contract Damages in Domestic Legal Systems and International Instruments', this volume.

[17] See D Saidov, 'Damage to Business Reputation and Goodwill under the Vienna Sales Convention', this volume.

[18] See http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG_status.html (accessed 18 October 2007).

but also introduce solutions which were thought to be most suitable for the needs of international commerce.[19] Secondly, these instruments are of a different legal nature than domestic regimes and they have undeniably marked a new stage in the development of truly international commercial law. Thirdly, notwithstanding a degree of skepticism still existing in legal circles regarding the movement to unify, harmonise and codify commercial law,[20] the international instruments have become firmly entrenched in the commercial and contract law world: they are regularly applied by judges and arbitrators, and used as models for legal reform in a number of states as well as for drafting international contracts.[21] Fourthly, it can certainly be argued that, in a number of areas, the instruments are superior to even some of the leading domestic systems[22] and for this reason domestic counterparts may have much to learn from them. Although the quality of many of the decisions under the CISG leaves a lot to be desired (for one thing, because it is applied in so many fora), there is now a substantial body of cases[23] (particularly in relation to damages) which, if comprehensively analysed,[24] may reveal and raise new problems and questions peculiar to international transactions with correspondingly novel solutions and analyses. Thus, while the instruments benefit from domestic regimes, the reverse is equally true.

Unfortunately (but not surprisingly), this mutual interaction has not been, in our opinion, entirely satisfactory. Courts applying the CISG not infrequently manifest what is known as the 'homeward trend', that is, the interpretation of the Convention from the standpoint of their own domestic system. One reason is, of course, the lack of knowledge of the Convention's regime, purpose and spirit, together with the lack of desire to gain that knowledge. The latter, we believe, is a major obstacle to a potentially fruitful interaction between domestic regimes and the Convention. Nowhere is this criticism more relevant than in the context of English

19 *UNIDROIT Principles of International Commercial Contracts 2004* (Rome, International Institute for the Unification of Private Law, 2004) xv.

20 For a well-known exposition of this criticism, see JS Hobhouse, 'International Conventions and Commercial Law: The Pursuit of Uniformity' (1990) 106 *LQR* 530.

21 With respect to the UPICC, see, eg MJ Bonell, 'UNIDROIT Principles 2004—The New Edition of the Principles of International Commercial Contracts Adopted by the International Institute for the Unification of Private Law' (2004) 45 *Uniform Law Review* 5, 6–17.

22 See the quotation by Roy Goode reproduced in the main text below.

23 For a constantly growing collection of cases under the CISG, see, eg www.cisg.law.pace.edu (accessed 18 October 2007).

24 Some recent attempts to do so in the context of damages include H Stoll and G Gruber, 'Arts 74–77 CISG' in P Schlechtriem and I Schwenzer (eds), *Commentary on the UN Convention on the International Sale of Goods (CISG)* (Oxford University Press, 2nd edn, 2005) and CISG Advisory Council (CISG-AC) Opinion No 6 'Calculation of Damages under CISG Article 74', available at http://www.cisg.law.pace.edu/cisg/CISG-AC-op6.html (accessed 18 October 2007). For a forthcoming work dedicated wholly to this subject, see D Saidov, *The Law of Damages in International Sales—The CISG and Other International Instruments* (Oxford, Hart Publishing, 2008).

commercial law, and Roy Goode's powerful argument is worth recalling here:

> Nowhere is [a] chauvinistic approach better exemplified than in our attitude towards the Vienna Sales Convention . . . it is for the most part a good deal better than our own Sale of Goods Act . . . it may serve the English party much better than a foreign domestic law to which that party might otherwise be subject . . . Why cannot we give leadership and in so doing increase our influence on transnational commercial law?[25]

E Final Remarks

A few final remarks remain to be made. First, so far as the comparison between the instruments themselves is concerned, it needs to be noted that such an exercise may involve more than just achieving the purposes set out above. Thus, the preamble to the UPICC provides that the Principles 'may be used to interpret or supplement international uniform law instruments', and the question as to the extent to which the UPICC can supplement the provisions of the CISG on damages is still unresolved. In his contribution to this volume, John Gotanda sets out his views as to the relationship between the two instruments.[26] His argument is that:

> while the UPICC should not exert influence of their own force in interpreting the CISG, they can facilitate an understanding of the general principles and help support a gap filling rule derived from general principles of the CISG.

Secondly, some time ago, it was said that the law of damages is a field of contract law which is 'particularly fraught with national variation'.[27] This leads us to wonder whether, so far as most legal systems (both domestic and transnational) are concerned, there is now a common way of thinking about contract damages. It is difficult to give a definite answer. On the one hand, as Komarov has shown, the methods of limiting damages used in different systems do not present a great deal of diversity and the international instruments, by and large, contain rules and concepts which are known to many domestic systems, and this may point towards an affirmative answer.[28] It can also be argued that the fact that representatives of different legal systems manage to agree on a set of rules on damages is in itself evidence of the existence of a common way of thinking about damages. On the other hand, commercial law can be partly viewed as a

[25] R Goode, *Commercial Law in the Next Millennium* (London, Sweet & Maxwell, 1998) 95.

[26] J Gotanda, 'Using the UNIDROIT Principles to Fill Gaps in the CISG', this volume.

[27] See BM Cremandes, 'The Impact of International Arbitration on the Development of Business Law' (1983) 31 *American Journal of Comparative Law* 530.

[28] This is, of course, subject to the instruments' requirement that they be interpreted independently of domestic law and in accordance with the instruments' international character.

reflection of the level of economic and business development and culture to be found in a given country. In this regard, Komarov suggests that there is a link between the level of detail with which the law of damages is developed in a particular system, on the one hand, and the degree of economic development and the level and diversity of commercial turnover in a particular country, on the other. In particular, he states that:

> [a]s a rule, less developed legal techniques are to be found in countries with a lower degree of industrialisation and an insufficient diversity of commercial turnover as well as where private legal relationships are underdeveloped.

Thus, while lawyers may naturally admire sophisticated and well-developed sets of rules and principles governing contract damages in a particular legal system, such a high level of sophistication and development may not necessarily be needed or, indeed, appropriate for some countries. However, a decision not to develop a detailed structure of the law of damages may flow not only from considerations linked to the country's economic and commercial development but also from some other considerations, and examples of such an approach can be found in systems with both a high level of economic development and a long-standing legal culture and tradition. Komarov refers to the new Dutch Civil Code, which contains no fixed or formal criteria for determining damages except some principles intended to provide general guidance.[29] It follows, from this discussion, that there is still a variety of ways in which the rules on contract damages are structured and the extent to which they are developed. And, perhaps, diversity is what is needed. If, in a global market place, various legal regimes (domestic and international) are viewed, in a way, as products on a market, then the potential consumers (that is, commercial people and their lawyers) would arguably want to have a choice.

III THE DEFINITION AND PURPOSE OF DAMAGES

A General

In this section, we examine four fundamental issues relating to the definition and purpose of damages: the first, that of the availability of non-compensatory measures of damages, is a relatively recent topic for debate stimulated by the House of Lords' decision in *Attorney General v Blake*; the second, concerning the nature and essence of the law of damages, is a relatively underexplored, and we would suggest much neglected, topic; the third and fourth issues are much more widely

[29] 'Thus, Article 97 simply gives the authority to a court to assess damages in a manner most appropriate to their nature' (Komarov, above n 16, with further references).

discussed in the literature and concern the age-old debates about the analytical structure and the normative basis of the law of contract. We believe that the essays contained in this volume make important contributions to each of these issues.

B The Definition of Damages and the Availability of Non-compensatory Awards

Given the large number of works on the law of damages,[30] one would have expected the definition of damages to be fixed and beyond dispute, but it appears that this is not so. Harvey McGregor opened the most recent edition of his work on damages with the following words:

> A resounding definition of the term damages would make for a fitting opening of a work on the law of damages and in their first sentence earlier editions have done just this. But it has become more and more difficult, as time has moved on, to construct a definition of damages which is satisfactory and which is comprehensive. So many exceptions to, and qualifications upon, once solid, clear, unadulterated rules have appeared, perfectly sensibly, that a clear-cut definition is no longer feasible; the arrival of restitutionary damages and of human rights was the last straw. The impossible search for a clear-cut comprehensive definition is therefore abandoned.[31]

We would suggest that the problem is not so much with defining damages per se but more with defining damages in the specific terms that were characteristic of previous editions of *McGregor*. In the aftermath of *Attorney-General v Blake*, it is no longer possible to limit damages to compensation. Nor can it be said that damages are only available in actions based on common law wrongdoing.[32] Perhaps the most specific definition we can give today is that 'damages are a monetary award given for a wrong'.[33]

[30] See, eg H McGregor, *McGregor on Damages* (London, Sweet & Maxwell, 17th edn, 2003); S Waddams, *The Law of Damages* (Toronto, Canada Law Book, 4th edn, 2004); AM Tettenborn, D Wilby and D Bennett, *The Law of Damages* (London, Butterworths Tolley, 2003); A Ogus, *The Law of Damages* (London, Butterworths, 1973).

[31] McGregor, *ibid*, 3 [1-001].

[32] Damages are now available for statutory wrongdoing under s 8 of the Human Rights Act 1998 and it is now quite common for judges to refer to equitable compensation as damages: *Bartlett v Barclays Bank Trust Co Ltd (No 2)* [1980] Ch 515 (Ch) 545 (Brightman LJ); *Bristol and West Building Society v Mothew* [1998] Ch 1 (CA) 17 (Millett LJ); *Cia de Seguros Imperio v Heath (REBX) Ltd* [2001] 1 WLR 112 (CA) 125 (Clarke LJ).

[33] See J Stapleton, 'A New "Seascape" for Obligations: Reclassification on the Basis of Measure of Damages' in P Birks (ed), *The Classification of Obligations* (Oxford, Clarendon Press, 1997) 193; R Cunnington, 'The Measure and Availability of Gain-Based Damages for Breach of Contract', this volume.

The nature and availability of non-compensatory measures of damages is addressed in a number of the essays in this volume. Stephen Smith,[34] Anthony Ogus[35] and Schwenzer and Hachem all address the availability of punitive damages. They all concede that such awards are not currently available in English law or under the CISG, but each proposes a role for punitive damages in certain exceptional cases.[36] Schwenzer and Hachem suggest that punitive damages should be awarded in cases where the breach of contract was intentional and in bad faith in order to provide full compensation for the aggrieved party. Ogus, on the other hand, suggests a more limited role, restricting punitive damages to cases where the party in breach sought to 'cover up the breach' or evade its contractual liability.[37]

Several of the essays address the measure and availability of gain-based damages. Andrew Burrows[38] and Stephen Waddams[39] adopt contrasting analytical approaches to this topic. Waddams applies what he refers to as a historical approach, suggesting that 'considerations of justice, undue enrichment, restitution, and compensation were all in operation' in the cases where gain-based damages were awarded.[40] Burrows, on the other hand, argues that all attempts to analyse *Wrotham Park* damages as a form of compensation are unrealistic. He prefers a restitutionary analysis, viewing *Wrotham Park* damages as a partial disgorgement of a fair proportion of the contract breaker's profits. While Ralph Cunnington agrees with Burrows that *Wrotham Park* damages are gain-based rather than compensatory, [41] he insists that a distinction must be drawn between damages that reverse a transfer of value (*Wrotham Park* damages) and damages that disgorge the contract breaker's profit (*Blake* damages).[42]

Regarding the issue of when gain-based damages ought to be available, Waddams suggests that a number of factors ought to be taken into account, including:

[34] S Smith, 'The Law of Damages: Rules for Citizens or Rules for Courts?', this volume.

[35] A Ogus, 'The Economic Basis of Damages for Breach of Contract: Inducement and Expectation', this volume.

[36] Although Smith provides no view on the desirability of punitive damages for breach of contract in his chapter, see his earlier work: S Smith, 'Performance, Punishment and Contractual Obligations' (1997) 60 *MLR* 360.

[37] See also S Smith, 'Performance, Punishment and Contractual Obligations' (1997) 60 *MLR* 360, 375.

[38] A Burrows, 'Are "Damages on the *Wrotham Park* Basis" Compensatory, Restitutionary or Neither?', this volume.

[39] S Waddams, 'Gains Derived from Breach of Contract: Historical and Conceptual Perspectives', this volume.

[40] The question of whether gain-based damages can be treated as a proxy for compensation in circumstances where loss is difficult to measure is dealt with below in our consideration of the meaning and definition of loss.

[41] R Cunnington, 'The Measure and Availability of Gain-Based Damages for Breach of Contract', this volume.

[42] The importance of this distinction is discussed below in relation to the availability of these measures of damages.

—the availability of specific enforcement;
—the proprietary or quasi-proprietary nature of the interest infringed;
—whether the claimant has been deprived of a valuable opportunity to bargain;
—whether the claimant has a legitimate non-economic interest that is not adequately compensated by the ordinary measure of damages;
—whether the defendant is unjustly enriched by retaining the gain;
—whether the claimant would be perceived as receiving a windfall if the gain were transferred;
—whether the breach of contract is reprehensible; and
—whether there was a public interest in deterring it.

Cunnington prefers a single criterion and ties the availability of gain-based damages to the availability of specific relief. He does, however, draw a distinction between cases in which the court 'cannot' order specific relief (in which case, he suggests that account of profits is appropriate) and cases in which the court 'will not' order specific relief (in which only *Wrotham Park* damages should be available).

A substantial part of Burrows's chapter is dedicated to examining Robert Stevens's 'rights-based' approach to damages. Stevens argues that *Wrotham Park* damages are neither compensatory nor restitutionary but are instead awarded in substitution for the right infringed by the contract breaker.[43] Burrows rejects this approach, arguing that it is impossible for it to be reconciled with the current state of the law. In particular, he suggests that it contradicts the law on mitigation, is inconsistent with the rules on the date of assessment, is liable to lead to double recovery and renders nominal damages redundant. Burrows also questions whether we sensibly can, or would want to, put a value on the right infringed by the contract breaker without any consideration of the actual impact of the infringement.

C The Nature of the Law of Damages

Although there exists voluminous literature on the analytical structure of the law of damages and on the normative basis for damages, very little has been written on the nature of the law itself. Few commentators have asked the question: what precisely is the law of damages? Smith's chapter analyses

[43] R Stevens, *Torts and Rights* (Oxford University Press, 2007) ch 4. Other commentators have adopted a similar analysis but within a compensatory framework: see M McInnes, 'Gain, Loss and the User Principle' (2006) 14 *Restitution Law Review* 76; J Edelman, 'Gain-based Damages and Compensation' in A Burrows and Lord Rodger (eds), *Mapping the Law* (Oxford University Press, 2006) 153–8. See also Cunnington's chapter in this volume.

the kinds of rights that are dealt with by the law of damages and asks whether those rights are private law rights or public law rights. He suggests that there are three main categories of rights that the courts take into account when making damages orders: (i) the rights that citizens enjoy against other citizens prior to any action by the court ('ordinary rights'); (ii) the rights that citizens enjoy against courts ('remedial rights'); and (iii) the rights that citizens enjoy against other citizens by virtue of orders made by courts ('court-ordered rights'). The first and third categories constitute private law rights, while the second concerns public law rights. The relationship between the three categories is both complex and symbiotic. In some cases (eg an action for payment of a debt), the court-ordered right will be derived from the claimant's remedial right and its content will be derived from the creditor's ordinary right to payment. In other cases, however (eg orders of punitive damages), the court-ordered right will be non-derivative and created at the time of the order. The law of damages is correspondingly complex.

Smith suggests that there are four kinds of court orders. First, there are orders that have a mixed private/public law explanation. Here the claimant's court-ordered right is derived from a combination of the claimant's remedial and ordinary rights. An order to pay a debt is a classic example. Secondly, there are orders that have a pure private law explanation. In this category, the content of the order is fixed by the claimant's ordinary right but the claimant has no remedial right to the order. Smith suggests that an order of specific performance would be an example, but admits that this is by no means uncontroversial. Thirdly, there are orders with a pure public law explanation. This category comprises orders to which the claimant has a remedial right but whose content is not dictated by the claimant's ordinary right. Smith suggests that monetary restitution in a *quantum valebant* claim would fall into this category. Fourthly, there are orders with no legal explanation. The existence and content of these orders is completely within the discretion of the court. A remedial constructive trust is a possible example.

Smith suggests that this reconceptualisation of court orders is of importance at both a theoretical and a moral level. It determines when the moral obligation to pay damages arises (which inevitably has important practical implications as well) and is important to judges (and other lawmakers) who have the responsibility of determining what morality requires them to do in their particular office. The reconceptualisation is also important for legal scholars who strive to better understand and explain the law of damages. Smith concludes that the law as it stands lumps together qualitatively different kinds of monetary orders under the heading of 'damages'. These groups, he suggests, need to be disentangled, although the question as to which group should retain the label 'damages' must remain a question for the future.

D The Interests Protected by an Award of Damages

There has been a lot of debate in the academic literature about the nature of the interests protected by an award of damages. Perhaps the best known article is that of Fuller and Perdue, in which they argued that an award of damages pursued three purposes: (i) protection of the restitution interest; (ii) protection of the reliance interest; and (iii) protection of the expectation interest.[44] The writers contended that it was the reliance interest rather than the expectation interest that deserved the protection of the courts, and that expectation damages are only justified because they provide a proxy for reliance loss and operate as a deterrent to losses incurred through detrimental reliance. Almost 60 years after Fuller and Perdue's article was published, Daniel Friedmann wrote a devastating response.[45] He reasserted the primacy of the 'performance interest' (his preferred term for the expectation interest) and suggested that it was only the terminology and not the substantive content of Fuller and Perdue's thesis that has exercised influence over the development of the law.

Friedmann's chapter in this volume[46] examines the distinct roles played by damages and specific performance in the protection of the performance interest. His central thesis is that an order of specific performance protects the subjective value of the promised performance whereas an award of damages protects its objective value. This has a number of significant implications. First, the assessment of damages will generally not take into account subjective elements such as distress, vexation and aggravation, whereas specific performance will ordinarily remedy those harms. Secondly, specific performance will be more advantageous to the aggrieved party where the subjective value that she places upon the promised performance exceeds its objective value (eg the *Ruxley* case[47]). Thirdly, damages will be more advantageous in situations where the subjective loss to the aggrieved party is lower than the objective loss assessed for the purpose of damages. Fourthly, the contractual rules of remoteness are irrelevant to an order of specific performance and the burden of mitigation has only a limited role to play. Fifthly, specific performance may benefit third parties for whom damages may not be available. Friedmann maintains that both damages and specific

[44] LL Fuller and WR Perdue, 'The Reliance Interest in Contract Damages' (1936) 46 *Yale Law Journal* 53. Although some commentators have equated the restitution interest with awards of gain-based damages, it is clear from what Fuller and Perdue actually wrote that what they had in mind was the action for autonomous unjust enrichment.

[45] D Friedmann, 'The Performance Interest in Contract Damages (1995) 111 *LQR* 628.

[46] See D Friedmann, 'Economic Aspects of Damages and Specific Performance Compared', this volume.

[47] *Ruxley Electronics and Construction Ltd v Forsyth* [1996] AC 344 (HL).

performance operate to protect the performance interest of the contract but that they do so in vastly differing ways.

Peter Jaffey, in his contribution to the volume,[48] prefers a reliance-based account of contracting, insisting that the basic measure of contract damages is the reliance measure. He recognises that the orthodox promissory analysis provides a simpler account if one looks at damages alone, but suggests that the promissory analysis fails to explain other aspects of the law of contract remedies, such as the absence of a general right to specific performance or disgorgement. Jaffey argues that the reliance theory explains all of these rules. The expectation measure rule is justified on the ground that expectation damages quantify the opportunity cost of the contract that the aggrieved party made with the contract breaker. The inadequacy requirement limiting the availability of specific relief and disgorgement is explained on the grounds that those remedies are only available in situations where actual performance, as opposed to pecuniary compensation, is necessary to ensure that the aggrieved party is protected against reliance loss. Jaffey also contends that the reliance analysis provides a better explanation of the actions that are traditionally assigned to the law of unjust enrichment. He criticises the attempts made by unjust enrichment theorists to assign these actions to the unjust factors of 'failure of basis' or 'failure of condition', arguing that these very labels demonstrate that the claim is in essence a contractual one. Jaffey suggests that his agreement-based reliance theory provides a much more plausible account of such claims, explaining why recovery is capped by the expectation measure and why losses are redistributed evenly following the frustration of a contract.

E The Economic Basis of Contract Damages

Much ink has been spilt, especially on the other side of the Atlantic, on analysing contract law from a law-and-economics perspective.[49] The best known theory is, of course, the efficiency theory of contract, which regards contract law as an instrument for promoting economically efficient behaviour. From this perspective, the justification for contract remedies is not that they recognise or vindicate rights, but that they provide incentives for economically efficient behaviour. According to this approach, contract remedies should never operate to deter economically efficient breaches. This, the legal economists argue, explains why specific performance

48 P Jaffey, 'Damages and the Protection of Contractual Reliance', this volume.

49 Leading examples of such economic analyses include: R Posner, *Economic Analysis of Law* (New York, Aspen Publishers, 6th edn, 2003); R Cooter and T Ulen, *Law and Economics* (Boston, MA, Pearson/Addison Wesley, 5th edn, 2007); AM Polinsky, *An Introduction to Law and Economics*, 3rd edn (New York, Aspen Publishers, 3rd edn, 2003).

remains an exceptional remedy in Anglo-American law,[50] and why gain-based damages are unnecessary except where they can be used to deter opportunistic breaches of contract.[51]

A number of essays in this volume address the law-and-economics approach to damages. Ogus accepts the orthodox formulation of the efficient breach theory and shows how the goal of allocative efficiency justifies awarding expectation damages as the default remedy for breach of contract. He does, however, suggest that the default rule requires a number of modifications if the law is to consistently induce economically appropriate behaviour. First, he identifies the problem of imperfect monitoring and enforcement (ie situations where the defendant is able to conceal the breach and evade liability), and suggests that in such cases gain-based or even punitive damages may be appropriate. Secondly, he argues that the courts should be willing to reduce damages on the grounds of contributory negligence if it can be shown that it would be cheaper for the promisee to take precautions to avert, or reduce the risk of, a breach. This, he argues, would provide an incentive for promisees to engage in economically efficient behaviour pre-breach and would mirror the function performed by the doctrine of mitigation in relation to post-breach behaviour. Thirdly, Ogus suggests that the rules on the availability of damages for non-pecuniary loss may have been too narrowly drawn. He suggests that the reason for this is the difficulty encountered by judges when attempting to formulate rules as to their availability. He further argues that economic reasoning can assist here, and that damages for non-pecuniary loss should be available whenever it can be shown that the promisee was willing to pay, and perhaps did pay, an additional premium in order to have the promisor insure him against the loss.[52]

Jaffey's contribution to this volume also engages with the economic analysis of contract damages. He suggests that the expression 'efficient breach' is self-contradictory. It implies that at one and the same time a contracting party has a duty to perform and also a liberty not to perform. Jaffey suggests that this paradox can be avoided if the argument for efficient breach abandons the idea that agreements ordinarily generate duties of performance and instead adopts the view that agreements create merely liabilities, rather than duties (the agreement-based reliance theory that Jaffey proposes).

50 A Kronman, 'Specific Performance' [1978] *University of Chicago Law Review* 351; A Schwartz, 'The Case for Specific Performance' (1979) 89 *Yale Law Journal* 271; W Bishop, 'The Choice of Remedy for Breach of Contract' (1985) 14 *Journal of Legal Studies* 299.

51 Posner, above n 49, 119.

52 A similar argument is made by Schwenzer and Hachem in their contribution to this volume. Adam Kramer also notes that the price paid for the promise will reflect the content of the allocation of risks under the contract: A Kramer, 'Remoteness: New Problems with the Old Test', this volume.

Friedmann, who is a well-known critic of the efficient breach theory,[53] suggests, in his chapter, that there is a role for the concept of 'tolerated breach' within the law of contract.[54] This concept would apply in situations where the parties have entered into a wasteful contract, that is, a contract in which the loss to one party that would result from its performance exceeds the benefit that would be acquired by the other party. Friedmann gives the example of a contract for the construction of a four-storey building on a plot of land where, shortly after the contract is agreed, a change in the zoning laws makes it possible to build up to 30 stories on the site. Completion of the contract would lead to significant waste since the four-storey building would need to be torn down in order to enable the construction of a 30-storey structure. In such cases Friedmann suggests there is no room for specific performance or gain-based damages. Tolerated breach differs from efficient breach in three fundamental ways: (i) it examines the economic rectitude of the contract from the point of view of both parties, whereas the efficient breach theory examines the situation from the point of view of the party in breach alone; (ii) it compares the actual losses and actual gains derived from the performance of the contract, whereas efficient breach compares the gains derived from the breach with the sum that would be payable in damages; and (iii) it leaves the decision whether to enforce the contract down to the court (there is no 'right' to breach the contract), whereas efficient breach assumes that the decision whether to perform or breach lies with the promisor alone.

Finally, one further chapter touches on an important economic aspect of damages, that is, on the currency of the award. Charles Proctor traces the demise of the 'sterling only' rule in relation to debt and liquidated damages claims.[55] He recognises that the issue is much more complex in relation to unliquidated damages claims because of the difficulty of implementing the principle that damages are to be awarded in the currency in which loss has been suffered or which truly expresses the loss. While taking the view that this principle was probably implemented correctly in *Texaco Melbourne*[56], Proctor suggests that the House of Lords erred in two important respects: (i) by insisting that the date for assessment should be the date of breach (Proctor recognises that the law has already started to evolve in this area—see the discussion of the *Golden Victory*[57] below); and (ii) by failing to appreciate that a loss in one currency can be felt by reference to its value in relation to another currency. Proctor suggests that if awards of

[53] See, eg D Friedmann, 'The Efficient Breach Fallacy', (1989) 18 *Journal of Legal Studies* 1.

[54] According to Friedmann, a breach is 'tolerated' if it is 'acceptable, even though it is not condoned'.

[55] C Proctor, 'Changes in Monetary Value and the Assessment of Damages', this volume.

[56] [1994] 1 Lloyd's Rep 473 (HL).

[57] [2007] UKHL 12 (HL).

damages are really to reflect the economic value of the loss sustained by the aggrieved party a more flexible approach needs to be adopted.

IV THE MEANING AND DEFINITION OF LOSS

A General

We believe that the meaning and definition of loss are issues which lie at the very heart of the law of contract damages. One reason for this assertion is that the compensatory purpose of damages cannot be satisfactorily implemented unless there is clarity as to what constitutes a loss. Another reason is that, by discussing the meaning of loss, we inevitably enter the debate about the values, policies and purposes that the law of contract should protect. It is also inevitable that this debate, like a wave, spills over the boundaries beyond those delineating the territory of compensatory damages.[58] The questions of meaning and definition of loss are therefore of great complexity, and in order to fully expose and address this complexity, the questions will have to be dealt with on a number of different levels.

One level is that of the different heads of loss and the question of whether a particular type of loss should be recognised by the law as sufficiently real, serious or important to qualify for legal protection. Another level is that of the dilemma every legal system faces between the so-called 'abstract' and 'concrete' approaches to the calculation of damages. This dilemma also poses, in a particularly acute form, other problems relating to the application of some of the methods of limiting damages, such as the mitigation rule.[59] The next level, which is not amenable to an easy separation, is that of the nature, meaning and role of the protection of the 'performance interest' of the contract. Yet another level, which is once again interlinked with some of the previous ones, relates to the extent to which the law can take into account the gains made by the defaulting party in the calculation of the loss sustained by the aggrieved party. Finally, there is a connection between the meaning of loss and, more broadly, various aspects of the law of damages, on the one hand, and the issue of contractual distribution of risk, on the other. While this volume does not aim to provide an exhaustive treatment of all these issues, many of them are touched upon in the essays contained herein.

[58] See the above discussion on the availability of non-compensatory measures of damages.

[59] For the recognition, in some of this volume's contributions, of the relationship between the foreseeability rule and the issues of 'abstract' calculation, see below.

B The Recoverability of Losses

The recoverability of various heads of loss is addressed in several contributions to this volume. Two essays address the question of whether injury to business reputation and goodwill constitutes a recoverable loss under the CISG. Schwenzer and Hachem argue that this loss should be recoverable as business reputation and goodwill have an economic value in which substantial investments are made. Similarly, Saidov, having examined the nature and the existing definitions of reputation and goodwill, concludes that these phenomena often constitute 'business assets' performing a number of important commercial functions and, for this reason, damage to these assets should be recognised as a recoverable loss under the Convention. Saidov also highlights, drawing on the developments in the law and outside it, some possible methods of proving and calculating this loss, with a special emphasis on its relationship with other potentially related losses, such as loss of custom, loss of a chance to enhance reputation and loss of profit. Michael Furmston[60] addresses the issue of the recoverability of damages for loss of a chance in the common law. He believes that, in comparison with contract cases, a different line of reasoning has been taken by the courts in medical negligence cases. He suggests that this is wrong and that the same rules ought to apply in relation to both contract and tort.

The recoverability of legal fees under the CISG is another issue which has received a large amount of attention (perhaps undeservedly so, considering the number of other unresolved issues that exist in the law of damages).[61] Schwenzer and Hachem consider this issue by, first of all, drawing a distinction between litigation costs and pre-litigation costs. They argue that the former should not be recoverable as damages under the Convention, despite the support that the contrary position may derive from the principle of full compensation. The argument follows the premise that recognising litigation costs as recoverable losses would contravene the principle of equality (symmetry) between the buyer and the seller: while the claimant will be able to recover those costs in the event that it wins the case, the respondent will not. So far as pre-litigation costs are concerned, the authors suggest that, while some such costs (eg those incurred in an attempt to mitigate losses) should be recoverable, others, such as those which cannot be neatly separated from litigation costs (eg those incurred to assess the party's legal position, prospects of litigation and/or settlement negotiations), should not be recoverable.

Schwenzer and Hachem also address the question of whether damages for loss of a chance are recoverable—a matter still shrouded by uncertainty

60 See M Furmston, 'Actual Damages, Notional Damages and Loss of a Chance', this volume.

61 See sources referred to in nn 51–8 in Schwenzer and Hachem's chapter in this volume and n 31 in Gotanda's.

under the CISG. Similar to their argument in relation to damage to reputation, the authors submit that a chance has an economic value in the light of the substantial sums often invested in it (eg in taking part in a bid), and therefore damage to it should be treated as a loss. They also argue that, because the sole difference between loss of a chance and loss of profit lies in the level of certainty with which they can be proven (ie loss of a chance involving a greater degree of speculation), the recoverability of loss of a chance can be inferred from Article 74 of the CISG, which expressly allows damages for 'loss of profit'. In the authors' view, this wording 'naturally encompasses' the recoverability of damages for loss of a chance.

In the age of constantly fluctuating exchange rates, the question of whether exchange rate losses arising from a breach of contract are recoverable is of great practical importance. Charles Proctor's chapter is a helpful contribution in this respect. It addresses, amongst other issues, the recoverability of exchange rate losses arising from delay in payment. Having analysed the relevant body of case law, Proctor demonstrates that currency exchange losses are in principle recoverable as damages for breach of contract, subject to the usual rules of foreseeability (remoteness). However, as Proctor notes, in *President of India v Lips Maritime Corporation*,[62] exchange rate losses arising from the late payment of demurrage was held not to be recoverable as damages. Proctor regards this result as somewhat unfortunate considering that:

> damages may be awarded for late payment of freight, but not for late payment of demurrage, in spite of the fact that they will both be expressed as liquidated amounts which are payable under the same contract.

C 'Concrete' v 'Abstract' Calculation

As noted above, at the heart of the current debate on the meaning of loss is the question of whether a 'concrete' or an 'abstract' approach to the calculation of damages ought to be applied.[63] The former approach aims to assess damages by reference to the injured party's actual circumstances, while the latter, in its pure form, does not look at the party's actual position but is instead based on the presumption that loss consists of the amount determined on the basis of a fixed formula, thereby awarding damages 'in abstract'. For example, these formulae include those which, in cases of non-delivery or non-acceptance of goods, assess damages by reference to

[62] [1988] AC 395.

[63] Although there is a degree of controversy surrounding such terms as 'abstract/concrete' or 'subjective/objective' approaches to calculation (see n 57 in Cunnington's chapter), considering the international and comparative scope of this volume the terms 'concrete' and 'abstract' are used as they appear to be more widely used in legal literature relating to the international instruments (particularly, in relation to the CISG).