

## The Aims of Compensatory Damages in Contract, Tort and Restitution

As long as obligations exist in our everyday lives, it is reasonable to assume that these obligations – whether they arise out of contract, tort or restitution – will be breached. “Once the plaintiff has established that the defendant is in breach of an obligation, he will normally seek damages to compensate for the loss flowing from the breach”<sup>1</sup>. It is necessary, however, when discussing compensatory damages, to make a “simple inquiry: toward what end is this activity directed?”<sup>2</sup>

The aim of contractual damages are to look forward to what the claimant was expecting if the contract had been fulfilled – the damages are protecting the claimant’s expectation interest. Per Parke B in *Robinson v Harman*: -

*“The rule at common law is that where a party sustains a loss by reason of a breach of contract he is, so far as money can do it, to be placed in the same situation with respect to damages as if the contract had been performed.”*<sup>3</sup>

Charles Fried<sup>4</sup> offers the opinion that contracts are enforceable because they are essentially promises, and that promises are enforceable because: -

*“There exists a convention that defines the practice of promising and its entailments. This convention provides a way that a person may create expectations in others. By virtue of ... basic ... principles of trust and respect, it is wrong to invoke that convention in order to make a promise, and then to break it.”*<sup>5</sup>

The aim of awarding expectation damages has its roots in economics. If “A” refuses to sell to “B” for an agreed price because he knows that “C” will pay more, it is more economically efficient to allow “A” to break his contract with “B” to maximise the exchange with “C” who will pay more. “B” can then be compensated for his loss in damages. The result is an economically “efficient” transaction. Other remedies for breach of contract do not achieve this result.

Expectation damages also encourage the claimant to mitigate the loss. Using the previous example, “B” can buy goods from a different supplier knowing that he will be compensated for the breach of contract when “A” sold to “C” instead. Again, this leads to efficiency in the market place.

However, it has been argued that an action for specific performance of the contract can be equally efficient as awarding compensatory damages because profits will still be made, it is just the distribution of these

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<sup>1</sup> *The Common Law of Obligations*, 3<sup>rd</sup> edition, J Cooke & D Oughton, p283

<sup>2</sup> *The Reliance Interest in Contract Damages* (1936) 46 Yale LJ 52, Fuller & Perdue

<sup>3</sup> *Robinson v Harman* (1848) 1 Exch 850 @ 855

<sup>4</sup> *Contract as a Promise – A Theory of Contractual Obligation*, C Fried

<sup>5</sup> *Ibid.*, p17

profits that will be different. The example above only takes into account the transactions within the contract, but other expenses, for example, negotiation, should also be taken into account when deciding whether the breach is efficient. There is also a degree of irony surrounding the efficient breach theory, which assumes individual, uncooperative behaviour that, in itself, can be highly inefficient in a business environment.<sup>6</sup>

Protection of the expectation interest can benefit every party in the contract. Its aim is to compensate loss to encourage efficient transactions rather than to punish the wrongdoer. However, while theoretically ideal, it can often be difficult to recover expectation damages, with hurdles such as remoteness<sup>7</sup>, mitigation and proof of loss all lying in the way of the claimant. The claimant may then try to recover his “reliance loss”<sup>8</sup> – the costs he incurred in reasonable reliance on the promisor performing the contract.<sup>9</sup>

Since this choice of claim exists, this might mean that the claimant could escape from a bad bargain by seeking to recover wasted expenditure. The English courts have made sure that this is not possible. If the defendant can prove that the claimant would not have recouped his expenses upon performance of the contract, no reliance damages are recoverable.<sup>10</sup>

Another controversial issue concerns expenses incurred before the contract was made. In England, this expenditure is recoverable; the rationale being that the defendant is under an obligation when the claimant has relied on his words or actions, “provided the reliance is sufficient to found a legal obligation”.<sup>11</sup>

In reality, the claimant is entitled to both the gains he was prevented from and the losses caused by the breach<sup>12</sup>. In *Hydraulic Engineering Co v McHaffie*<sup>13</sup> there is a judicial statement to the effect that this may lead to over-compensation of the claimant. However, this is only the case if gross profits and expenditure are recovered (the recovery of net profits only and wasted expenditure avoids this problem). Where expectation loss cannot be proved, or is speculative, the court may only award reliance losses.

In contrast to contract damages, tortious damages are backward looking and protect the status quo of the claimant. This is to say that the aim of the damages awarded is to place the claimant in the position he would have been in had the tort not have been committed. Per Lord Blackburn in *Livingston v Rawyards Coal Company*: -

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<sup>6</sup> *Efficient Breaches of Contract: Circles in the Sky* (1982) 68:5 Virginia L. Rev. 947

<sup>7</sup> See *Hadley v Baxendale* (1854) 9 Exch 341

<sup>8</sup> *CCC Films (London) Ltd v Impact Quadrant Films Ltd* [1984] 3 All ER 298

<sup>9</sup> *McRae v Commonwealth Disposals Commission* (1950) 84 CLR 377

<sup>10</sup> *C&P Haulage v Middleton* [1983] 3 All ER 94

<sup>11</sup> *The Common Law of Obligations*, 3<sup>rd</sup> edition, J Cooke & D Oughton, p330

<sup>12</sup> *The Law of Damages* (1973), A Ogus, pp346 – 347

<sup>13</sup> (1878) 4 QBD 670

*“That sum of money which will put the party who has been injured, or who has suffered, in the same position as he would have been in if he had not sustained the wrong for which he is now getting his compensation.”*<sup>14</sup>

Tortious damages’ first aim could be said to be purely pacificatory, where “the victim’s vengeance is bought off by compensation”<sup>15</sup>. However, in modern times this function probably takes a subordinate place as “we do not reckon on the recrudescence of family feuds as a serious possibility, or even that of duelling. However, it may be thought that unredressed torts would be regarded as a canker in society”<sup>16</sup>, and so this aim still has a use.

The payment of damages for a breach of a tort “is essential to the maintenance of the tort system as an effective, credible deterrent to negligence”<sup>17</sup>. Without some kind of punishment for the defendant, there is no reason, other than a matter of conscience, for him not to commit that tort again. Providing the guilty party with a punishment is a way of deterring unsafe conduct.

There is an economic reason for awarding compensatory tortious damages, and this is to prevent victims from taking too many precautions and therefore encourage productive activity. If a claimant will not be compensated for the defendant’s negligence, the defendant will deliberately be negligent, knowing that the claimant will have an incentive to incur a cost to avoid expected damages greater than this cost, and that if he does so the accident will be prevented and the defendant will be cleared. In this situation, liability lies with the “cheapest cost avoider”, an idea linked to the American “Learned Hand Test”<sup>18</sup> where liability depends on whether the “burden of precaution costs” are less than the “probability of harm” multiplied by the amount of compensation that would be awarded.

It has been argued that the tort law’s role in reducing levels of dangerous activity has been exaggerated. There are other behavioural controls apart from the law of tort that might exercise such a deterrent effect: -

*“Self-preservation instincts, market forces, personal morality, and governmental regulation ... combine to control unreasonably dangerous actions independently of tort law”*<sup>19</sup>

The deterrent theory has its roots in utilitarian philosophy, in which the imperfections of this theory can be found. According to this philosophy, a punishment must not be greater than is necessary to repress the mischief in question. Damages in tort may be greater than required, turning the idea of an award for damages as a deterrent into a punishment.

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<sup>14</sup> *Livingston v Rawyards Coal Company* (1880) 5 App Cas 25 @ 39

<sup>15</sup> *The Aims of the Law of Tort*, G Williams, [1951] CLP 137

<sup>16</sup> *Ibid.*

<sup>17</sup> *Economic Analysis of Law*, R Posner, p209

<sup>18</sup> *United States v Carroll Towing Co* (1947) 159 F 2d 169

<sup>19</sup> *Doing Away With Personal Injury Law*, S Sugarman, p128

There are further criticisms of the role of damages as a deterrent. Firstly, much of the conduct leading to liability in tort cannot be deterred, such as an error of judgement when driving a car. Secondly, it is unlikely that tortfeasors or the people they wrong against know about tort liability rules. Even if tort liability rules are known the deterrent message they give is confusing because there is only liability where the tort has led to injury and the degree of fault is irrelevant to the amount of compensation.<sup>20</sup>

However, as has already been mentioned, from *Livingston v Rawyards Coal Company* tortious damages are backward looking. The economic, appeasement and deterrent aims are forward looking. If one looks to restore the status quo of the claimant, then the aim of awarding damages is corrective justice. According to *Nichomachean Ethics*, this is the putting right of some wrong, thus restoring or redressing the balance of fairness that has been upset. This can be seen both in the litigation in which damages are sought, and in the doctrine of tort law generally, both of which show a bipolar relationship between the claimant and the defendant: -

*“Procedurally, litigation in [tort] takes the form of a claim that a particular plaintiff presses against a particular defendant. Doctrinally, requirements such as the causation of harm attest to the dependence of the plaintiff’s claim on a wrong suffered at the defendant’s hands.”*<sup>21</sup>

This is not to say that the instrumental goals of the award of damages (as a form of social control) in tort should be abandoned. This is because the concept of fault in tort is stretched to cover occurrences such as accidents at work. Without the compensatory aim of tortious damages, there would be no mechanism in place to compensate those who have lost out.

Even if it is taken that corrective justice is the only concern in the award of damages, Aristotle’s account of corrective justice never entailed a particular concept of wrongful conduct nor how this should be compensated, so it is merely a template that can be filled with different notions of “wrong” and “justice”. Therefore, there is nothing in the concept of corrective justice that requires the remedying of a tort by means of compensation. Nonetheless, the idea that the law ought to perform this function is appealing.

The function of the tort system as a method of punishment is seen easily when compared to some European jurisdictions in which victims of a tort are compensated by a national compensation scheme rather than by the tortfeasor.

A claimant may claim damages in restitution. This refers to the restoration to the claimant of a benefit conferred on the defendant to which the latter is not entitled. The principle behind restitution is unjust enrichment at another’s expense, in contrast with contract, where the underlying principle is agreement. If the defendant is enriched at the claimant’s expense, the money made by the defendant is awarded to the claimant.

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<sup>20</sup> Law Commission Consultation Paper 147, Part 4.12

<sup>21</sup> *The Idea of Private Law*, E Weinrib, p1

In conclusion, the classic theories that compensatory damages in contract protect the claimant's expectations and those awarded in tort protect the status quo of the claimant show a difference in the aims awarding the damages.

*“The difference between tort law and contract law lies in the origin of the right. In tort law, the plaintiff's right exists independently of the defendant's action; the damage award therefore aims at eliminating the effects on the plaintiff of the defendant's wrong. In contract law, the parties themselves create the plaintiff's right to the defendant's performance of the promised act; the damage award therefore gives the plaintiff the value of that performance.”<sup>22</sup>*

However, in reality, these theories have been added to by the award of damages to protect the claimant's reliance on a contract as well as the idea of instrumental goals of damages in tort. The effect of these additions has been to bring the aims of awarding compensatory damages in both contract and tort closer together, with the law in these areas now looking both forwards to wrongs prevented and backwards to remedy damage already caused.

The main objective, therefore, of awarding compensatory damages for breach of contract and tort, and in restitution, is as a form of social control. It is unacceptable to have a party to a contract losing out because he cannot prove the profit he would have made on performance of the contract. It is equally correct to say that a deterrent to negligence is necessary to protect citizens who might not know what they are entitled to if a tort is committed against them. It is morally justified to take profits from someone unjustly enriched by them and give them to the person from whose expense the profits were made.

The reason for having a legal system in general is to control people and provide a reason, other than conscience, for them not to commit unacceptable social and moral wrongs. The aims of awarding compensatory damages in contract, tort and restitution can be found firmly within this general framework of social control.

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<sup>22</sup> *The Idea of Private Law*, E Weinrib, p136