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## Reconsidering the Reliance Interest

Christopher W. Frost

*University of Kentucky College of Law*, cfros1@uky.edu

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## Reconsidering the Reliance Interest

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# RECONSIDERING THE RELIANCE INTEREST

CHRISTOPHER W. FROST\*

## I. INTRODUCTION

Among contract teachers and scholars, Fuller and Perdue's *The Reliance Interest in Contract Damages* ("*The Reliance Interest*")<sup>1</sup> is certainly an influential piece of legal scholarship.<sup>2</sup> Perhaps no single article in any legal discipline has had the pervasive impact on the way the law is taught. Nearly every contracts casebook makes reference to the work.<sup>3</sup> Most casebook authors provide it as a central organizing feature of the remedies section.<sup>4</sup>

Fuller's influence can also be felt in the organization of a contracts course. A traditionalist, I begin my contracts class with the case of *Hawkins v. McGee*.<sup>5</sup> The sad tale of George Hawkins provides a purpose-built vehicle to explore the contours of the expectation, reliance and restitutionary interests and measures of recovery. This tradition, memorialized in the book and movie *The Paper Chase*, traces its lineage back to the first edition of Fuller's influential casebook.<sup>6</sup>

Fuller and Perdue's taxonomy of interests and remedies has also had an effect on practice. Courts speak the language of the article.<sup>7</sup> The expectation,

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\* Brown, Todd & Heyburn Professor of Law, University of Kentucky College of Law. I thank my friend, colleague and teacher, Eugene Gaetke, for his thoughtful comments on a draft of this article.

1. L.L. Fuller & William R. Perdue, Jr., *The Reliance Interest in Contract Damages: 1*, 46 YALE L.J. 52 (1936) (hereinafter "*The Reliance Interest*") (setting out most of the theoretical underpinnings of Fuller and Perdue's framework for analyzing contract remedies); *The Reliance Interest in Contract Damages: 2*, 46 YALE L.J. 373 (1936) (hereinafter "*The Reliance Interest 2*") (applying the framework to various recurring problems in contract remedies).

2. See Todd D. Rakoff, *Fuller and Perdue's The Reliance Interest as a Work of Legal Scholarship*, 1991 WIS. L. REV. 203, 203 (1991) (describing *The Reliance Interest* as a "preeminent example" of an enduring article).

3. The use of *The Reliance Interest* in contracts casebooks is well summarized in Richard Craswell, *Against Fuller and Perdue*, 67 U. CHI. L. REV. 99, 105-06, 161 nn.23-25 (1999).

4. See *id.*

5. 146 A. 641 (N.H. 1929).

6. LON L. FULLER, BASIC CONTRACT LAW I (1947).

7. See, e.g., *Sullivan v. O'Connor*, 296 N.E.2d 183, 187 (Mass. 1973) (applying *The Reliance Interest* in awarding reliance damages). In 1991, Stewart Macaulay reviewed all of the cases citing *The Reliance Interest* or concerning reliance damages. See Stewart Macaulay, *The*

reliance and restitutionary measures of recovery provide general benchmarks from which courts more closely tailor remedies. Whether this can be attributed to the analysis' descriptive power or normative attractiveness or simply to the fact that most lawyers and judges were educated in the analysis is impossible to say.

There is considerable pedagogical value to starting contract problems by focusing on the stakes. In a general sense, the early focus on remedies reinforces students' appreciation of the fact that the law is intended to do something. It exists to right wrongs in a meaningful way. This approach sets a purposive tone for the course that forces students to move from abstraction to real effect. More specifically, Fuller and Perdue's methodology provides an early opportunity to engage students in standard legal reasoning. The formulaic approach channels their consideration of the facts of a specific case leading them to predictable numerical results. With a common starting point, the instructor is free to challenge the normative bases of the analysis and the factual assumptions on which the results rely.

Of course, the article has not met with universal acceptance. Three criticisms of the doctrine are particularly worthy of discussion here. David Barnes<sup>8</sup> and Michael Kelly<sup>9</sup> have both criticized the Fuller and Perdue classification. In their view, the separation of the reliance interest from the expectation interest serves to create confusion and adds little to the descriptive or normative power of Fuller and Perdue's analysis. Likewise, Richard Craswell<sup>10</sup> has made a two-pronged attack on the primacy of *The Reliance Interest* in practice, the classroom and contracts scholarship. His argument is that "Fuller and Perdue's classification has little relevance to modern normative debates and is not even a useful way of classifying the remedies case law."<sup>11</sup>

This essay discusses the place of *The Reliance Interest* in the contracts classroom. After first describing my use of *The Reliance Interest*, I will set out what I consider to be the pedagogical benefits of beginning the course with remedies and the attractiveness of Fuller and Perdue's analytical model in conveying an understanding of the remedial structure. Next, I will discuss the

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*Reliance Interest and the World Outside the Law Schools' Doors*, 1991 WIS. L. REV. 247, 266-68 (1991). At that time, he found seventy-three such cases. *See id.* Although, Macaulay opined that seventy-three cases in fifty-five years is not many citations, the real importance of *The Reliance Interest* is that it provided a tool to solve unusual and difficult cases. *See id.* at 271-72, 274.

8. *See* David W. Barnes, *The Net Expectation Interest in Contract Damages*, 48 EMORY L.J. 1137 (1999).

9. *See* Michael B. Kelly, *The Phantom Reliance Interest in Contract Damages*, 1992 WIS. L. REV. 1755 (1992).

10. *See* Craswell, *supra* note 3.

11. *Id.* at 101.

views of critics Craswell, Kelly and Barnes. Finally, I will revisit the place of Fuller and Perdue's work in the contracts course in light of these criticisms.

By way of caveat, this essay will make no attempt to support or defend the article's central thesis that the reliance interest presents a more attractive claim to judicial enforcement than does the expectation interest. Instead, my focus here is on the descriptive aspects of the framework and on the pedagogical advantages that framework presents. Also, as will become obvious, I usually do not assign the article to my students to read nor do I "teach the article" in any explicit way. Instead, Fuller and Perdue's work remains in the background, where its principal influence is in the organization of the discussion of remedies and the hypothetical situations I present.

## II. TEACHING THE FRAMEWORK

In all but one of the years I have taught Contracts, I have started the course with *Hawkins v. McGee*.<sup>12</sup> Most lawyers will recall this case either from law school or from the movie *The Paper Chase*. In the case, McGee, a surgeon, promised George Hawkins that an operation would leave him with "a hundred percent good hand."<sup>13</sup> Hawkins suffered substantial ill effects from the operation and sued.<sup>14</sup> The trial court's charge to the jury called for a tort-like measure of recovery, permitting the jury to award damages for Hawkins' pain and suffering and for the damage to the hand.<sup>15</sup> The New Hampshire Supreme Court reversed, holding that the correct measure of damages in the case was the difference between a perfect hand and the value of Hawkins' post-operative hand.<sup>16</sup> The court also found the instruction about pain and suffering erroneous, noting that pain and suffering was part of his consideration for the benefit of a perfect hand.<sup>17</sup>

The case is filled with jarring imagery, the sad condition of Hawkins' hand,<sup>18</sup> the incompetent surgeon, the court's analogy to a poorly repaired machine<sup>19</sup> and the reference to pain and suffering as consideration.<sup>20</sup> I deal

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12. 146 A. 641 (N.H. 1929).

13. *Id.* at 643.

14. *See generally id.* at 641-43.

15. *See id.* at 643. The trial court's charge to the jury was in substance, "[i]f you find the plaintiff entitled to anything, he is entitled to recover for what pain and suffering he has been made to endure and for what injury he has sustained over and above what injury he had before." *Id.*

16. *See id.* at 644.

17. *See Hawkins*, 146 A. at 644.

18. *See* Jorie Roberts, *Hawkins Case: A Hair-Raising Experience*, HARV. L. REC., Vol. 66, No. 6 (March 11, 1978), *excerpted in* RANDY E. BARNETT, *CONTRACTS: CASES AND DOCTRINE* 76-78 (2d ed. 1999).

19. *See Hawkins*, 146 A. at 643. The court stated:

The present case is closely analogous to one in which a machine is built for a certain purpose and warranted to do certain work. In such cases, the usual rule of damages for

with all of this up front—asking students why the case is brought in contract rather than tort<sup>21</sup> and whether a hand can be valued in the same way an appraiser might value a machine. Typically, I sense that some students have some discomfort with a contractual approach but in the main the students are prepared to indulge the approach, including the machine analogy, for purposes of discussion.

From there, I turn the discussion to a formulaic analysis of Fuller and Perdue's three contract interests. I usually ask one student simply to recite each of the damage calculations and to tell me how they would apply to the facts at hand. For purposes of the exercise, I generally attach numbers to each of the possible conditions of the hand. For example, I postulate that a perfect hand would be worth \$2,000. The pre-operative hand was worth \$1,500. The post-operative hand is worth \$500. Pain and suffering is valued at \$300. On these facts students easily come to the conclusion that expectation damages are \$1,500,<sup>22</sup> reliance damages \$1,300<sup>23</sup> and restitution \$0.<sup>24</sup>

At this point students are prepared to consider the relationships among the damage formulations. Students quickly take to the notion that restitution damages can be viewed as a subset of reliance damages and therefore that the outcome of the restitution formula will be less than or equal to that of the

breach of warranty in the sale of chattels is applied, and it is held that the measure of damages is the difference between the value of the machine, if it had corresponded with the warranty and its actual value . . . .

*Id.*

20. *See id.* at 644. According to the court:

The pain necessarily incident to a serious surgical operation was a part of the contribution which the plaintiff was willing to make to his joint undertaking with the defendant to produce a good hand. It was a legal detriment suffered by him which constituted a part of the consideration given by him for the contract. It represented a part of the price which he was willing to pay for a good hand . . . .

*Id.*

21. The complaint included a count of negligence, which was nonsuited without exception.

*See id.* at 641.

22. Expectation damages "put the plaintiff in as good a position as he would have occupied had the defendant performed his promise." Fuller & Perdue, *The Reliance Interest*, *supra* note 1, at 54. Thus damages are calculated by the difference between the value of the hand as promised (\$2,000) and its post-operative value (\$500).

23. Reliance damages "put [the plaintiff] in as good a position as he was in before the promise was made." *Id.* Thus reliance damages include the difference between the pre-operative and post-operative value of the hand (\$1,000) plus the pain and suffering attendant to the operation itself (\$300).

24. Restitution damages have as their object the prevention of unjust enrichment. *Id.* Since the doctor has received nothing of value from Hawkins, restitution damages are zero. Including a doctor's fee into the equation provides a quick way of putting restitution on the table and also showing the close relationship between restitution and reliance.

reliance formula.<sup>25</sup> Students usually extend that logic to the relationship between reliance and expectation, sometimes asserting plainly that reliance is always less than or equal to expectation.

Changing the hypothetical provides a convenient way of challenging that assertion. If we include a doctor's fee of \$500 total reliance damages of \$1,800 would exceed the \$1,500 expectation figure.<sup>26</sup> The change opens up an entirely new line of inquiry. Confronting students with the realistic possibility of a losing contract provides an opportunity to highlight the difference between a tort and a contract recovery and is a useful starting point for a discussion about the promissory basis of contract liability. *Hawkins* presents a particularly good fact pattern for the exploration of these issues. I suspect from most of my students' reactions to the case that they generally believe that *Hawkins* should have received the greater of reliance or expectation damages. When I pose a hypothetical that involves such excess reliance losses on a relatively simple commercial contract, however, the students are much more likely to want to limit damages to expectation.<sup>27</sup> With both hypotheticals in place, students can draw distinctions between cases that clearly rest on a promise and have clear cut market values (the commercial case) and cases that involve more subjective valuations and fit only uncomfortably within the confines of contract.<sup>28</sup>

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25. See Fuller & Perdue, *The Reliance Interest*, *supra* note 1, at 71 (describing the reliance interest as "broad enough to cover all of the cases coming under the restitution interest . . . [.]" but also "broad enough to embrace some cases not covered by that interest . . .").

26. Putting the promisee in the position the promisee would have been in had the promise never been made would on these facts require compensation for the ill effects on the hand (1,500 pre-operative - 500 post-operative = \$1,000) and pain and suffering (\$300) and the doctor's fee (\$500). Total reliance damages would then be \$1,800, exceeding expectation by \$300.

27. In addition, the prospect of losing contracts opens up a discussion of the difference between incidental and essential reliance which Fuller and Perdue use to explain cases like *Nurse v. Barnes*, Sir T. Raym 77 (Kings Bench 1664), reprinted in BARNETT, *supra* note 18, at 79. In that case a lessee of iron mills worth £20 was granted damages of £500 for stock purchased in reliance on the contract. To explain this result, Fuller and Perdue drew a distinction between essential reliance, reliance that involves part of the "price" the plaintiff is willing to pay and incidental reliance, reliance that does not involve performance. Fuller & Perdue, *The Reliance Interest*, *supra* note 1, at 78. They note that essential reliance must be limited by the contract price, otherwise we would be "permitting the plaintiff to shift to the defendant his own contractual losses, when the defendant is guilty of nothing more reprehensible than breach of contract." *Id.* Incidental reliance does not necessarily involve such a shift in losses. *Id.* Incidental damages should be limited by the expected profit of the business venture, not just the contract price. *Id.*

28. In this regard, *Sullivan v. O'Conner*, 296 N.E.2d 183 (Mass. 1973), provides an interesting comparison. In *Sullivan*, the plaintiff complained that her physician breached a promise to improve the appearance of her nose. See *id.* at 184. The operation failed. See *id.* Unlike *Hawkins*, the court noted the difficulties in valuation and the potentially harsh result that expectation damages might entail. See *id.* at 187-88. Citing *The Reliance Interest*, the court

*J.O. Hooker & Sons, Inc. v. Roberts Cabinet Co.*<sup>29</sup> presents a much more complex case and provides a good vehicle to introduce students to the connection between the reliance and the expectation measures of damage. In this case, Hooker engaged Roberts to furnish cabinets for a public housing project on which Hooker was the general contractor.<sup>30</sup> After Roberts incurred expenses for labor and materials, storage costs and administrative costs, Hooker breached by unilaterally terminating the contract.<sup>31</sup> The jury awarded lost profits on the entire contract, losses on completed but unaccepted goods, additional costs of storing completed but unaccepted goods, and the allocated cost of the manager's time actually spent in performing the contract.<sup>32</sup>

Hooker objected that the costs of storage and the costs of the manager's time were fixed costs that Roberts would have incurred regardless of entering into the contract.<sup>33</sup> The court drew a distinction between the items of damage—awarding the administrative costs but not the storage costs.<sup>34</sup> The court's decision was based on differing opportunity costs. The court noted that the space that Roberts used to store the cabinets would have remained empty had Hooker accepted the cabinets.<sup>35</sup> Thus the storage of the cabinets represented no loss resulting from opportunity costs. An award of an allocated portion of the general manager's salary was appropriate on the assumption that the time spent on the project was time that could not have been spent on other productive activities.<sup>36</sup> Thus, the devotion of the manager's time to the breached contract created an opportunity cost for which damages could be awarded.

This case provides an illustration of one of Fuller and Perdue's most important points—that the expectation measure and the reliance measure tend to converge.<sup>37</sup> While the court clearly was concerned with measuring the seller's expectation, the same result could have been reached through the application of the reliance measure of recovery. In reliance on the buyer's agreement, the seller committed its productive capacity, including the costs of labor and materials purchased and the cost of its manager's time. Had the buyer's promise never been made, the seller would have been free to commit

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applied the reliance measure, stating that the reason for granting damages based on the expectation interest are strongest in the commercial context. *See id.* at 188.

29. 683 So. 2d 396 (Miss. 1996). Barnett recently added this case to the second edition of his casebook. BARNETT, *supra* note 18, at 81-89.

30. *See J.O. Hooker & Sons, Inc.*, 683 So. 2d at 398.

31. *See id.* at 403-04.

32. *See id.* at 404.

33. *See id.*

34. *See id.* at 404-05.

35. *See J.O. Hooker & Sons, Inc.*, 683 So. 2d at 404.

36. *See id.* at 404-05.

37. *See Fuller & Perdue, The Reliance Interest, supra* note 1, at 73-75.



those resources to a profitable venture. On the other hand, because the breach forced the seller to use storage space which would not have been profitably committed in any event, nothing was truly lost.

The illustration of this principal has the additional advantage of providing a thorough discussion of profit and loss, including opportunity cost, early in the semester. The convergence of reliance (including opportunity cost) and expectation requires that students think through the way that businesses earn profit and the way that the contract and its breach might have interfered with that process. Naturally, many students come to law school with a general understanding of business concepts, but for most, I suspect, this class discussion is the first time they have been required to articulate it in any systematic fashion.<sup>38</sup>

Of course, this approach is only one way to introduce students to Fuller and Perdue's remedial framework. Depending on the casebook I have used, I have substantially adapted my approach to the materials.<sup>39</sup> In addition, I try to keep a store of simple, "on the fly" hypotheticals that I pull out to use as the circumstances warrant.<sup>40</sup> Equally obvious is the fact that this first day or two of class comes nowhere near unpacking all of the intricacies of Fuller and Perdue's analysis. That is a project that continues throughout the semester. Naturally, the framework figures large in our discussion of estoppel doctrines.<sup>41</sup> We spend a fair amount of time discussing the reliance interest in connection with mutual assent.<sup>42</sup> We also discuss subjective and objective expectation in connection with material breach—the point at which we take up *Groves v. John Wunder*<sup>43</sup> and the *Peevyhouse*<sup>44</sup> cases.

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38. The concept of opportunity cost has, on occasion presented a greater challenge for both my students and me. The unusually astute students will occasionally ask, "If a business is otherwise profitable why should opportunity cost on one particular contract make any difference?" Put more simply, "Why protect profitability when a business is breaking even?" This usually leads to a discussion of risk and the cost of capital. As a general matter, I try to attend to these sorts of questions after class for those who are interested.

39. For example, the Dawson, Harvey and Henderson book includes a separate case regarding a losing contract. See *Acme Mills & Elevator v. Johnson*, 133 S.W. 784 (Ky. 1911), reprinted in JOHN P. DAWSON ET AL., *CONTRACTS CASES AND COMMENT* 22-23 (7th ed. 1998). Barnett's casebook has a very good problem that is of use in approaching the materials. See BARNETT, *supra* note 18, at 79-80.

40. I try to keep these as simple as possible. Usually they involve a commodity rather than a unique item.

41. The reliance interest is especially prominent in cases such as *Goodman v. Dicker*, 169 F.2d 684 (D.C. Cir. 1948) and *Hoffman v. Red Owl Stores, Inc.*, 133 N.W.2d 683 (Wis. 1965).

42. The reliance interest is useful in explaining the objective theory of assent. See, e.g., *Embry v. Hargadine McKittrick Dry Goods Co.*, 105 S.W. 777, 779 (Mo. Ct. App. 1907) (noting that an employee has a "right to rely" on an employer's statement as signifying assent to enter into an employment agreement).

43. *Groves v. John Wunder Co.*, 286 N.W. 235 (Minn. 1935).

44. *Peevyhouse v. Garland Coal & Mining Co.*, 382 P.2d 109 (Okla. 1962).

I therefore view *Hawkins*, *Hooker* and related hypotheticals as presenting building blocks for the course. At a minimum, I expect that the three damage formulations and their application become second nature to my students. At best, my hope is that my students will come to understand that the remedies granted for contract breach are intimately related to the reasons that we enforce contracts.

### III. PEDAGOGICAL ADVANTAGES OF TEACHING THE FULLER AND PERDUE FRAMEWORK

Although not specifically tied to Fuller and Perdue's analysis, I find that one of the principal benefits of beginning the course by teaching remedies is that this approach sets a purposive tone to the course. Academics sometimes lose sight of a fact that most law students come to school knowing—the law exists to do. It has real effects on real people. Students with this perspective will become disenchanted with law school if the conclusion of every case or problem is simply judgment for the plaintiff or the defendant. Natural curiosity will lead students to ask what the case results really mean for the people and institutions involved. Indulging that curiosity provides a certain reality that class discussions otherwise lack. In addition, the early focus on remedies encourages students to study law by looking to what the courts do in addition to what they say.

Fuller and Perdue's identification of interests and formulae for damages also provides students an early example of what I shall call standard legal reasoning. Of course, if you asked ten different professors to define "standard legal reasoning," you would get (more than) ten different answers. Most teachers and lawyers would, however, agree that the legal reasoning (1) is somewhat predictable, (2) is purposive in the sense that it is goal directed and (3) operates within a framework rather than from a series of loosely connected rules. Despite the sophistication of many of my students, my sense is that, as a group, they come to law school without this understanding of the law.

First take predictability. We all know that in the real world predictability is only roughly accomplished.<sup>45</sup> Outcomes are the result of unstated assumptions and biases. Teaching, however, requires some common point of departure lest the discussion devolve into nothing more than unprincipled and undefined assertions of fairness. Making standard moves from general proposition to outcome through factual analysis is, of course, standard law school fair. I find that students generally have little difficulty moving through the facts and coming out in the same place. Even better, as usually happens when discussing the *Hooker* case, students come to predictably differing

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45. For an extreme statement of this position, see Macaulay, *supra* note 7, at 288, which states, "Imagining that rules of law create a high degree of predictability, and that, as a result, we gain freedom, is a rich fantasy."

outcomes depending on the assumptions that underlie their answers. Establishing the basic moves quickly frees the teacher to focus the students' attention on these assumptions and analyses.

Of course, predictability is only one attribute of standard legal analysis that is important to stress. In addition, the analytical mode requires a link between ends and means. Fuller and Perdue invoke corrective justice ends and remedial means in establishing their framework.<sup>46</sup> The proposition that the reasons for enforcing contracts is not self-evident can surprise some students whose views are products of cultural influence. In our culture, there is a morality associated with keeping one's word, and most people do not think much further than that. Confronting students with the myriad consequences of enforcing promises challenges the very simple positivist and formalist predispositions that our students bring with them.

Fuller and Perdue's analysis also presents students with more than a series of rules. The hierarchy of interests, the mathematical and conceptual relationships among those interests and the damage formulations that vindicate those interests create a structure rather than a loose collection of legal rules under a similar doctrinal classification.<sup>47</sup> The drive to organize sets of rules into coherent frameworks is a staple in standard legal analysis. Such frameworks can be as broad as the general classification of contracts, property and torts or as narrow as mutual assent and enforceability. As legal scholars, we are comfortable thinking and writing about frameworks without fanfare. As teachers of the completely uninitiated, we must be aware that our students may not naturally think about rules in terms of their relationship to each other. Fuller and Perdue offer us a way to present a small unit of material that is interrelated and internally consistent. Students can see the basic structure within minutes.

#### IV. CRITICISMS OF FULLER AND PERDUE'S FRAMEWORK

Notwithstanding the pedagogical advantages described above, teaching Fuller and Perdue's framework cannot be justified if the approach fails to provide either a compelling normative basis or a reasonable description of what courts actually do. Recent criticisms of *The Reliance Interest* require a rethinking of its role in our contracts courses. This section will take up the

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46. See *infra* notes 83-84 and accompanying text.

47. This, in Rakoff's view, is the real attraction of *The Reliance Interest*. He states, "[i]n my view, the genius of *The Reliance Interest* lies in its development of concepts that are linked to each other in multiple patterns to create a structure of considerable intellectual beauty and power." Rakoff, *supra* note 2, at 215. While some of the beauty of the patterns Rakoff discusses probably escapes law students' notice, *The Reliance Interest's* overall conceptual structure is relatively simple and easy for them to master.

views of three authors whose articles should be required reading for any contracts teacher who makes remedies a prominent part of her course.

In a 1992 article, Michael Kelly argued that Fuller and Perdue's definition and emphasis on the reliance interest creates needless confusion that could be avoided by eliminating reliance as a separate category of damages.<sup>48</sup> If, as Fuller and Perdue argue, reliance encompasses lost opportunities, there is no real need to treat reliance as a separate category of damages. In Kelly's view, the expectation measure of recovery can do all of the normative work Fuller and Perdue demand.<sup>49</sup>

According to Kelly, the sin of *The Reliance Interest* is that in creating it, "Fuller and Perdue divorced purpose and practice more completely than they ever admitted; they divorced the reliance interest as applied from the reliance interest as defined."<sup>50</sup> While Fuller and Perdue seemed to be advocating the application of the "pure reliance interest" (reliance including lost opportunities), most of *The Reliance Interest*, and most of the scholarly response to it, views reliance as including only actual expenditures made in reliance on the contract—what Kelly calls the "Expenditure Measure."<sup>51</sup>

This reinterpretation of the reliance interest results in a somewhat forced and artificial analysis. For example, one of Fuller and Perdue's insights was that reliance must be limited by the expectation interest in losing contracts.<sup>52</sup> Kelly notes that the expectation interest could produce the same result, but Fuller and Perdue can only accomplish this result by abandoning the retrospective focus of the reliance measure in favor of a forward looking inquiry into the future expectation of the plaintiff.<sup>53</sup> In Kelly's words this approach "seems a square expectation peg forced into a round reliance hole."<sup>54</sup>

The mischief is not limited to normative inconsistency, however. In Kelly's view a crabbed view of reliance leads to outcomes that cannot be normatively justified under a forward-looking view of contract remedies.<sup>55</sup> As an example, he discusses the controversy over whether precontractual expenditures are recoverable in a case in which the plaintiff is unable to prove lost profits.<sup>56</sup> In such cases, Fuller and Perdue state that the reliance interest is most appropriate.<sup>57</sup> However, the reliance measure would deny recovery where the plaintiff is unable to prove lost profits because precontractual

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48. See Kelly, *supra* note 9, at 1758-59.

49. See *id.* at 1811-45.

50. *Id.* at 1758-59.

51. See *id.* at 1768.

52. See *id.* at 1783.

53. See Kelly, *supra* note 9, at 1783-85.

54. *Id.* at 1783.

55. See *id.* at 1783-84.

56. See *id.* at 1815-25.

57. See Fuller & Perdue, *The Reliance Interest 2*, *supra* note 1, at 373-77.

expenditures could not have been made in reliance on the contract.<sup>58</sup> In Kelly's view, this assumes that the plaintiff would have incurred a loss on the contract simply because the amount of the loss could not be proven.<sup>59</sup> Applying the expectation measure of recovery with a presumption that the plaintiff's business proposition would have broken even had the contract been performed would result in recovery for the precontractual expenditures.<sup>60</sup>

More recently, David Barnes has argued that Fuller and Perdue's analysis can be simplified by eliminating reliance in favor of what he calls the "net expectation interest."<sup>61</sup> He defines the net expectation interest as the individual's interest in the improvement in her well-being resulting from the contract.<sup>62</sup> Barnes views the net expectation interest as having a normative basis that is independent of the normative basis of the reliance interest.<sup>63</sup>

In Barnes' view, Fuller and Perdue's efforts to explain the routine grant of expectation damages are strained.<sup>64</sup> He states, "While it is clever to suggest an approximation justification for awarding lost profits, it is much more straightforward to conclude that there is independent justification for ensuring that the injured party is placed in as favorable a position as the other's performance would have done."<sup>65</sup> Indeed, Barnes suggests that this justification is necessary since Fuller and Perdue's approximation justification requires an unrealistic assumption of perfect markets.<sup>66</sup>

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58. See Kelly, *supra* note 9, at 1815-16.

59. Kelly cites *Chicago Coliseum Club v. Dempsey*, 265 Ill. App. 542 (Ill. App. Ct. 1932). In that case, boxer Jack Dempsey breached a contract with a promoter to fight Harry Wills. The promoter was unable to prove lost profits, so the court granted reliance damages for post-contractual expenses. The court denied recovery for pre-contractual expenditures of \$50,000 because those expenses were not incurred in reliance on the contract. Kelly observes that the court must have presumed that the fight would have generated enough revenues to cover the post-contractual expenses. Therefore, according to Kelly, it seems a small step to presume that the revenues would have been sufficient to cover pre-contractual expenses as well. Kelly, *supra* note 9, at 1820-23.

60. See *id.* at 1822-23.

61. See Barnes, *supra* note 8, *passim*. Barnes describes his approach as conceptually simpler than Fuller & Perdue's reliance framework. *Id.* at 1204.

62. *Id.* at 1139. However, inasmuch as expectation measures the promisee's hypothetical post contract position, the net expectation appears to measure the same thing.

63. *Id.* at 1157-70.

64. See *id.* at 1165-66.

65. *Id.* at 1166.

66. See Barnes, *supra* note 8, at 1166. Fuller and Perdue also recognized that the justification is most forceful in "perfect" markets. See Fuller & Perdue, *supra* note 1, at 62. However they do not rely solely on the "perfect" markets explanation. In addition to the approximation justification, they state that the expectation interest can serve as a prophylaxis against reliance losses by deterring breach. See *id.* at 61.

Barnes also believes that Fuller and Perdue's approach creates a real potential for confusion in addition to unnecessary complication.<sup>67</sup> Like Kelly, Barnes cites the confusion surrounding cases in which profits cannot be proven with certainty.<sup>68</sup> He states, "Contract law casebooks . . . present recovery of out-of-pocket costs as reflecting pursuit of a different 'interest.' Casebook authors might more simply characterize the award as reflecting an amount that comes as close as possible to guaranteeing the net expectancy, given problems of proof."<sup>69</sup>

Like Kelly and Barnes, Craswell finds Fuller and Perdue's classification unhelpful in describing contract remedies.<sup>70</sup> Craswell's descriptive structure places expectation damages at the center of a framework that groups remedies based on whether they equal, exceed or fall short of the expectation measure.<sup>71</sup>

One of Craswell's key insights is that remedies sometimes exceed expectation in pursuit of some retributive goal.<sup>72</sup> An obvious example is the rare case in which courts award punitive damages based on bad faith.<sup>73</sup> A less obvious, but perhaps more accepted example, is the award of cost-of-completion damages for defective performance rather than damages based on the diminution in market value.<sup>74</sup> Craswell argues that cases in which the award exceeds expectation cannot be dismissed as presenting mere measurement error because courts seem sensitive to the willfulness of the breach in making the award determination.<sup>75</sup> Even less obvious are the cases in which courts seem to demand varying degrees of certainty regarding lost profits based on the wrongfulness of the breaching party's behavior.<sup>76</sup> Fuller and Perdue's classification system has no room for these types of cases because they insist that expectation is the limit on recovery.<sup>77</sup>

With regard to cases that award expectation or less than expectation, Craswell finds Fuller and Perdue's reliance/expectation categories wanting.<sup>78</sup> Unlike Kelly and Barnes, who argue that expectation alone can do all of the work of Fuller and Perdue's reliance interest without the complications, Craswell sees Fuller and Perdue's categories as failing to provide enough

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67. See Barnes, *supra* note 8, at 1199.

68. See *id.*

69. *Id.* at 1199-200. Barnes notes a similar problem when lost profits are unforeseeable under *Hadley v. Baxendale*. *Id.* at 1197-99.

70. See Craswell, *supra* note 3, at 137.

71. See *id.* at 157.

72. See *id.* at 138-43.

73. See *id.* at 138.

74. See *id.* at 139.

75. See Craswell, *supra* note 3, at 139-40.

76. See *id.* at 140.

77. See *supra* note 29 and accompanying text.

78. See Craswell, *supra* note 3, at 143-54.

nuance.<sup>79</sup> According to Craswell, reliance, as a category, includes dissimilar cases and therefore the category is over-inclusive.<sup>80</sup> At the same time, similar cases are sometimes grouped under the reliance category and sometimes under the expectation category, and therefore, the category is under-inclusive.<sup>81</sup> In short, Craswell finds a number of circumstances in which courts award something between reliance and expectation, and the cases defy facile categorization.<sup>82</sup>

All three of these critical articles share a common theme: the reliance interest introduces too many difficulties for too little descriptive power. This criticism would be fatal if all we are looking for is a descriptive model. If, however, Fuller and Perdue are correct that the reliance interest has normative significance, the difficulties might be tolerated. The framework would have a normative justification for its place in our contracts classes, despite its lack of guidance as a descriptive model.

As noted above, I will leave the normative evaluation of Fuller and Perdue's articles to the reader. A symposium on teaching contract law seems an unlikely place to win converts to any particular normative vision. For our purposes, it is enough to note that Fuller and Perdue's analysis finds its normative force in corrective justice ideals.<sup>83</sup> Their remedial structure is designed to protect individual and societal interest in Aristotelian balance.<sup>84</sup> Their approach is backward-looking. It asks where the damage was wrought and how it can be repaired.

In contrast to Fuller and Perdue's corrective justice theory, many theories of contract enforcement are consequentialist. Economic theories, for example, ask what types of judicial interventions produce incentives that will reduce social costs overall.<sup>85</sup> While some outcomes of this type of analysis may resemble those of Fuller and Perdue, the resemblance will only be coincidental. For example, Fuller and Perdue explain that the rule in *Hadley v. Baxendale*,<sup>86</sup> like the reliance interest, provides a middle ground between complete, but onerous enforcement and no enforcement at all.<sup>87</sup> They state that the "fundamental implication" of *Hadley* is that "it is unwise to impose too onerous consequences on breach of contract."<sup>88</sup> Presumably, for them, full

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79. *See id.* at 154.

80. *See id.* at 149-50.

81. *See id.* at 151.

82. *See id.* at 153-54.

83. Fuller & Perdue, *The Reliance Interest*, *supra* note 1, at 56-57.

84. *See id.*

85. *See* Craswell, *supra* note 3, at 107-08.

86. 156 Eng. Rep. 145 (1854), *reprinted in* ROBERT E. SCOTT & DOUGLAS L. LESLIE, CONTRACT LAW AND THEORY 99 (2d ed. 1993).

87. Fuller & Perdue, *The Reliance Interest*, *supra* note 1, at 87.

88. *Id.*

contract enforcement would exceed the requirements of the corrective justice norm. Economic theorists, on the other hand, view the *Hadley* rule in consequentialist terms.<sup>89</sup> They ask, "What rule will insure the most efficient combination of information transmission and precautions against breach?"<sup>90</sup>

While there may be many cases in which the two justifications will result in the same outcome, it is possible that the outcomes could differ depending on the justification. Fuller and Perdue state that "losses through reliance are not immune to the objection of 'remoteness;' yet because they make a stronger appeal to judicial sympathy than a claim for lost profits, the objection of remoteness is applied less strictly to them."<sup>91</sup> Suppose for example that the seller under a contract for the sale of land incurred larger than ordinary legal expenses in preparing to perform a contract. Upon the buyer's breach, the seller sought to recover all of the expenses as reliance damages. The legal expenses would, under Fuller and Perdue's analysis, constitute essential reliance expenditures and should be recoverable notwithstanding the fact that they may have been unforeseeable by the buyer. An economic analysis, however, might deny the seller recovery of these unforeseeable damages because to do so would give sellers an incentive to disclose their unique situations, which in turn would cause buyers to take appropriate precautions against breach. The choice of normative theory drives both the analysis and the outcome.

Thus, as the critics assert, Fuller and Perdue's article may fail both as a normative and as a descriptive framework. Then, the question becomes whether the framework should be consigned to the museum or continue to be taught as the overall organizing theme of contract remedies.

#### V. RECONSIDERING *THE RELIANCE INTEREST*

Traditions die hard, as they should. Law teachers could introduce real incoherence if they radically changed their course to adjust for each passing academic fad. At the same time blind adherence to discredited theories leads to stagnation. Failure to account for contemporary trends leads to a loss of relevance. Fortunately, I suspect that, for many of us, nothing about these criticisms of *The Reliance Interest* creates such a dilemma. This is not because I find the critiques unpersuasive. On the contrary, all three articles contain important insights regarding the limitations of Fuller and Perdue's framework that I will most certainly take into account as I begin teaching contract

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89. See Craswell, *supra* note 3, at 107.

90. Lucian Ayre Bebchuk & Steven Shavell, *Information and the Scope of Liability for Breach of Contract: The Rule of Hadley v. Baxendale*, 7 J.L. ECON. & ORG. 284, 285-86 (1991).

91. Fuller & Perdue, *The Reliance Interest 2*, *supra* note 1, at 377. Of course, Fuller and Perdue would limit this statement to essential reliance. Incidental reliance is subject to the *Hadley* rule. Fuller & Perdue, *The Reliance Interest*, *supra* note 1, at 87-88.



remedies next fall. These insights however require additions to my course rather than a replacement of my existing approach.

As indicated above, *The Reliance Interest* does not occupy an independent place in my contracts course. I do not assign the article to my students nor do I place great emphasis on its structure or normative underpinnings. Instead, the article lives in the background, informing my hypotheticals and helping to set the goals for the course. Under this limited use, much of the framework holds together even under the critiques. Regardless of one's view of *The Reliance Interest* students need to understand expectation and restitution as measures of damages. They occupy the poles with restitution representing the "no contract" end and expectation representing the "full contract" end. The question then is how to deal with the middle. Should reliance continue to occupy this vast ground as Fuller and Perdue suggest?

In large part this question is merely semantic. Courts use the term "reliance" to refer to those out of pocket losses that were incurred as a direct result of the promise—what Kelly calls the "Expenditure Measure." Thus, as a benchmark against which one can evaluate remedies, the reliance measure of damages seems to occupy a place of some significance. Perhaps it would be better to refer to this sense of "reliance" by a different term, but the fact remains that most people use the term "reliance" to describe expenditures. In teaching the basic concepts, the label should not matter much so long as the teacher is careful to draw the correct analytical distinctions.

Next fall, the place I will draw these distinctions is the point at which the class connects the reliance and expectation measures. Upon making the point that the reliance interest, taken literally, becomes indistinguishable from the expectation interest, I will ask whether there is anything left of the reliance interest. I expect that my students will understand that the reliance measure must mean something different from the expectation measure. Introducing that problem should set the class hour off on a discussion of all of these issues. At bottom, the insights presented by Fuller and Perdue's critics can only serve to enrich the class discussion. That is not a bad thing so long as we remember that the goal is to give the students a sense of (1) the language the courts use and (2) the conceptual distinctions and normative justifications that sometimes exist independent of that language.

## VI. CONCLUSION

No legal framework is without its limitations. The remedial framework set out in *The Reliance Interest* is no exception. One of the joys of teaching, learning and practicing law is that the action lies in the exceptions to and limitations of, the grand theories. A careful rereading of both parts of Fuller and Perdue's work and the thoughtful critiques of that work can only serve to enhance that joy. As I sat down to write this essay, I thought that I knew how to teach contract remedies. As I conclude, I still think that, but I can see

additional possibilities. This is one of the main reasons we read and write—it makes us better teachers.