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Role of Reliance in Contract Damages

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THE ROLE OF RELIANCE IN CONTRACT DAMAGES

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INTRODUCTION

It has long been established that the normal measure of damages for breach of contract is the so-called expectation measure—a sum that puts the injured party in as good a position as if the contract had been performed. Two other measures also are available: reliance and restitution. Because these measures usually provide a smaller amount of damages, they are generally used ouly when the expectation measure is for some reason not available (*e.g.*, the evidence upon which the expectation measure rests is not sufficiently certain). The reliance measure puts the injured party in as good a position as if the contract had never been made; the restitutional measure returns to the injured party any benefits (or their money equivalent) that the breaching party gained at the injured party's expense.[1]

Two views, however, challenge the expectation measure's preeminent place. The older and better known, which I will sometimes refer to as the estoppel-exception view, derives from arguments first made in the preparation of the promissory estoppel sections of the *Restatement (First) of Contracts*,[2] published in 1932. At that time, commentators asserted that the reliance measure of damages should be the most to which the injured party was entitled for breach of a contract resting on estoppel (instead of on consideration). Other commentators expressed the same opinion after the *Restatement (First)* was published, and a few courts subsequently limited damages on this ground or at least seemed to. The *Restatement (Second) of Contracts*,[3] published in 1981, implicitly recoguized this view when it expanded the principal promissory estoppel section to read that the remedy in such a case "may be limited as justice requires."[4] Most contract casebooks currently in print mention the estoppel-exception view and include cases, and sometimes commentary, on it.

The other view challenging the expectation measure did not emerge until 1980 when it was put forward by some members of the

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1 E. ALLEN FARNSWORTH, CONTRACTS §§ 12.8, 12.16 (1982) (reliance measure); *id.* §§ 12.19, 12.20 (restitutional measure).

2 RESTATEMENT (FIRST) OF CONTRACTS (1932) [hereinafter RESTATEMENT (FIRST)].

3 RESTATEMENT (SECOND) OF CONTRACTS (1981) [hereinafter RESTATEMENT (SECOND)].

4 *Id.* § 90.

law and economics movement. Its proponents argue that the expectation measure provides excessive assurance of performance and thus leaves the promisee without sufficient incentive to limit his reliance. The promisor therefore bears a liability in excess of the value of his performance, leaving society as a whole less well off—less efficient, in economic terms. This view does not espouse the reliance measure as the preferred alternative, but its supporters are critical of the expectation measure. They bave proposed means of diminishing the importance of the promisee's reliance in determining the promisor's liability. To my knowledge, no court decision has yet reflected this view, nor has any contract casebook mentioned it.

It is the thesis of this Article that both of these views are wrong. Both rest on unwarranted assumptions or mistakes of law or fact. The lion's share of this Article deals with the view that estoppel damages should be limited by the reliance measure because the former's much longer history has supplied it with more aspects that need to be taken into account. I will begin with a description and analysis of its origins in the preparation of the *Restatement (First)*.

I. THE MEASURE OF DAMAGES IN AN ESTOPPEL CASE

A. *The Restatement (First) of Contracts*

Prior to 1932, consideration was both the necessary and the sufficient condition for enforcement of a promise. The doctrine of estoppel was confined to statements of fact, and it sounded in tort. Some reported decisions conflicted with this generality, but they were too few to constitute an alternative branch of law. No litigant could have confidently relied on them.[5] As is now well known, the *Restatement (First) of Contracts*, published in 1932, changed all this. Its section 90 reduced consideration to a sufficient, but not necessary, condition for enforcement of a promise. It did this by expanding estoppel to include promises as well as factual statements. This new promissory estoppel doctrine sounded in contract, although "factual estoppel," as the older doctrine came to be called, continued to be regarded as sounding in tort.

Samuel Williston and Arthur L. Corbin created promissory estoppel. Williston, the foremost contracts scholar of his day, served as the Reporter for the *Restatement (First)*. The younger Corbin already had a national reputation and would become the foremost

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[5] A search of LEXIS and WESTLAW in June 1989 found no cases in point prior to 1932 that were not cited in the Reporter's Note to RESTATEMENT (FIRST) § 90. Only two early cases are cited in the Reporter's Note: Ricketts v. Scothorn, 57 Neb. 51, 77 N.W. 365 (1898), and Roberts-Horsfield v. Gedicks, 94 N.J. Eq. 82, 118 A. 275 (1922), *aff'd mem.*, 96 N.J. Eq. 384, 124 A. 925 (1924). Even they arguably support the law as § 90 stated it.

contracts scholar upon the passing of Williston. The two of them had little trouble introducing promissory estoppel into the *Restatement*. Only a few members of the Contracts Section of the American Law Institute opposed the concept, and their opposition apparently had no basis other than that the common law did not already include the doctrine.[6] It was the proposed remedy, which Williston and Corbin assumed would be the same as for breach of contract, that engendered opposition. Opponents of expectation damages argued that the estoppel remedy should be limited to compensating the promisee for his reliance.[7] The basis for these scholars' position is unclear; they may have expected the remedy to match the original grounds of enforcement, as it sounded in tort.[8] In any event, Williston tactically agreed to add to section 90 that promises that would otherwise be enforceable by estoppel *vel non*, were instead "binding if injustice can be avoided only by [their] enforcement . . . ."[9]

The added phrase is, to say the least, enigmatic. The section makes a promise enforceable only if the promisor ought reasonably to have foreseen the promisee's reliance *and* if the promisee in fact relied to his substantial detriment. These requirements alone appear to be sufficient to make enforcement of the promise necessary in order to avoid injustice; the added phrase seems superfluous and it gives no hint of limiting the remedy, while still regarding the promise as binding.

Unlike the *Restatement (Second)*, the *Restatement (First)* has no official comments, but it does have official illustrations.[10] The illustrations for section 90, however, expose the meaninglessness of the added phrase rather than clarifying it. They do not demonstrate *any* way in which the appended qualification is to affect whether a promise is binding. They also do not provide any guidance on the question of limiting the remedy. The illustrations all end merely by saying that the promise concerned is, or is not, "binding," without saying anything about the appropriate remedy.

One suspects Williston of having hoodwinked the opposition. He overcame it by agreeing to add language that he then rendered meaningless through his choice of illustrations and lack of explanation.

Judge Learned Hand of the United States Court of Appeals for

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6 "A promise which the promisor should reasonably expect to induce action or forbearance of a definite and substantial character on the part of the promisee and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise." RESTATEMENT (FIRST), *supra* note 2, § 90.

7 *See* 4 A.L.I. PROC. 85-114 (App. 1926).

8 *See, e.g., id.* at 98-100, 110-12.

9 RESTATEMENT (FIRST) § 90.

10 *E.g., id.*

the Second Circuit rendered the first major decision on section 90. *James Baird Co. v. Gimbel Brothers*,[11] was decided the year after the *Restatement (First)* was published. Several general contractors, including the James Baird Company, were bidding on a construction job. Gimbel Brothers wanted to do the linoleum flooring work, and sent its subcontracting bid to all of these general contractors. The subcontract bid contained the language, " 'If successful in being awarded this contract, it will be absolutely guaranteed, . . . and . . . we are offering these prices for reasonable' (sic) 'prompt acceptance after the general contract has been awarded.' "[12] The James Baird Company relied on the low prices in the linoleum bid in preparing its own bid, which it submitted before receiving word from Gimbel Brothers that it was revoking the linoleum bid and would substitute another at about double the prices.

The bid of the James Baird Company on the construction job was accepted. Gimbel Brothers thereafter refused to recognize the existence of a contract, and the James Baird Company completed its work using another linoleum subcontractor. It sued Gimbel Brothers on the theory of promissory estoppel. The Second Circuit affirmed the district court's judgment for Gimbel Brothers on several grounds. One was that promissory estoppel applies only to donative promises, which the court defined as promises made without the expectation of receiving an equivalent in exchange. Promissory estoppel therefore does not apply to offers, which are made for an exchange and are not expected to become promises until and after the exchange has been received.[13] A second ground was that there was "not the least reason to suppose that [Gimbel Brothers] meant to subject itself to such a one-sided obligation"[14] as would be the case if its offer was interpreted as an option.

The first ground is illogical because it overlooks the possibility dismissed in the second. If the offer was an option, then the additional promise of nonrevocation was "donative," since the grantor of the option, by definition, did not expect an equivalent in exchange. And the second ground, that the offer could not have been intended as an option, is simply incredible. In view of the circumstances and the prices being " 'absolutely guaranteed . . . for reasonable' (sic) 'prompt acceptance after the general contract has been awarded,' "[15] it seems clear that Gimbel Brothers *had* intended to subject itself to "such a one-sided obligation." What else could

11 64 F.2d 344 (2d Cir. 1933).
12 *Id.* at 345.
13 *Id.* at 346.
14 *Id.*
15 *Id.* at 345.

these words mean? In any event, *James Baird Co. v. Gimbel Brothers* died on the vine. Even now, fifty-seven years later, not a single decision follows it.[16] With this lone exception, every court of last resort that addressed the question accepted promissory estoppel. By 1969 almost every jurisdiction had adopted it.[17]

B. Decisions Limiting the Remedy in Estoppel Cases after 1932

Of the possibly hundreds of reported decisions applying promissory estoppel since 1932, only three have been widely read as holding that damages in a promissory estoppel case are limited to the reliance measure. The first is *Goodman v. Dicker*,[18] a 1948 decision of the United States Court of Appeals for the District of Columbia. The defendant made representations and gave assurances to the plaintiff that the plaintiff had, or would get, a franchise for selling the defendant's products. The plaintiff made expenditures in reliance.[19] The main defense on appeal was that the franchise would have been terminable at will anyway.[20] The court dismissed this defense because it "miss[ed] the real point of this case."[21] The court held that the situation was appropriate for the application of "equitable estoppel," citing two very old United States Supreme Court decisions.[22] The court never acknowledged the existence of promissory estoppel. Equitable estoppel is the *factual* estoppel that existed *in the law of tort* before the *Restatement (First)* was published. *Goodman v. Dicker* is nevertheless included in seven contracts casebooks as authority for limiting the remedy to the reliance measure of damages in a promissory estoppel case.[23]

The Supreme Court of Wisconsin handed down *Hoffman v. Red*

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16 A search of Shepard's Federal Citations confirms this.

17 Stanley D. Henderson, *Promissory Estoppel and Traditional Contract Doctrine*, 78 YALE L.J. 343 (1969).

18 169 F.2d 684 (D.C. Cir. 1948).

19 *Id.* at 684.

20 *Id.*

21 *Id.* at 685.

22 *Id.* (citing Arizona v. Copper Queen Mining Co., 233 U.S. 87, 95 (1914); Casey v. Galli, 94 U.S. 673, 680 (1876)).

23 JOHN P. DAWSON, WILLIAM BURNETT HARVEY & STANLEY D. HENDERSON, CASES AND COMMENT ON CONTRACTS 268-71 (5th ed. 1987); E. ALLAN FARNSWORTH & WILLIAM F. YOUNG, CASES AND MATERIALS ON CONTRACTS 229 (4th ed. 1988); LON L. FULLER & MELVIN ARON EISENBERG, BASIC CONTRACT LAW 39-40, 290 (4th ed. 1981); FRIEDRICH KESSLER, GRANT GILMORE & ANTHONY T. KRONMAN, CONTRACTS: CASES AND MATERIALS 209-12 (3d ed. 1986); CHARLES L. KNAPP & NATHAN M. CRYSTAL, PROBLEMS IN CONTRACTS LAW: CASES AND MATERIALS 916 (2d ed. 1987); JOHN E. MURRAY, JR., CASES AND MATERIALS ON CONTRACTS 290-92 (3d ed. 1983); ROBERT S. SUMMERS & ROBERT A. HILLMAN, CONTRACT AND RELATED OBLIGATION: THEORY, DOCTRINE, AND PRACTICE 297-300 (1987).

Owl Stores, Inc.[24] in 1965. In *Hoffman*, the plaintiff substantially relied for several years on the defendant's promises and assurances that the plaintiff would get one of the defendant's franchised retail outlets if he met two conditions. First, the plaintiff had to cooperate with the defendant in learning the business; second, he had to supply an $18,000 investment. As time wore on, the plaintiff depended more and more upon the defendant's good faith by relinquishing his former business holdings and moving himself and his family to various parts of the state at the defendant's insistence. The defendant also raised the plaintiff's investment requirement by increments to $34,000. Because the plaintiff could not raise this much money, he gave up[25] and sued on grounds of promissory estoppel. The defendant, however, asserted that no contract existed and that its assurances and promises were only negotiations intended to lead to a contract.

The Supreme Court of Wisconsin affirmed the award of reliance measure damages to the plaintiff on the ground that *both* parties' arguments were essentially correct. A contract never existed because the parties never agreed on enough essential details, but the defendant's promises were sufficient to trigger promissory estoppel.[26] In limiting recovery to reliance damages, the court relied on the Restatement's provision that a promise is binding "if injustice can be avoided only by enforcement of the promise."[27] The court quoted excerpts from two commentators to the effect that this provision gave courts *discretion* to limit damages in promissory estoppel cases.[28] The court also cited a third excerpt that argued that reliance damages were the most that a court should award in any promissory estoppel case.[29] Despite this citation, the court's language clearly shows an intent to use discretion only to limit damages where appropriate on the facts of a case rather than to limit damages in all estoppel cases.[30] *Red Owl* therefore does not support the proposition that estoppel case plaintiffs are limited to recovery of reliance damages; it supports only the weaker proposition that a

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24 26 Wis. 2d 683, 133 N.W.2d 267 (1965).

25 *Id.* at 691, 133 N.W.2d at 271.

26 *Id.* at 696, 133 N.W.2d at 275.

27 *Id.* at 698-99, 133 N.W.2d at 275 (citing RESTATEMENT (FIRST) § 90).

28 *Id.* at 701-02, 133 N.W.2d at 276-77 (quoting 1A ARTHUR LINTON CORBIN, CORBIN ON CONTRACTS § 200, at 221 (1963); WARREN L. SHATTUCK, *Gratuitous Promises—A New Writ?*, 35 MICH. L. REV. 908, 912 (1937)).

29 *Id.* at 702, 133 N.W.2d at 277 (quoting Warren A. Seavey, *Reliance upon Gratuitous Promises or Other Conduct*, 64 HARV. L. REV. 913, 926 (1951)).

30 *See id.* at 701, 133 N.W.2d at 276 ("Where damages are awarded in promissory estoppel instead of specifically enforcing the promisor's promise, they should be only such as in the opinion of the court are necessary to prevent injustice.").

court has *discretion* to limit the plaintiff's recovery to reliance damages in an estoppel case.

Because the opinion offers no guidance on how this discretion should be exercised, the case left Wisconsin law in a confusing state. There are established rules for refusing expectation damages in certain cases. However, these rules rigidly require the presence of specific facts. The rules therefore operate to create exceptions rather than exercises of discretion. The most common rule, for example, is that a court should reject expectation damages unless it can estimate them with reasonable accuracy. Either there is insufficient evidence (for example, of the profits that would have been made by a new business),[31] or the broken promises were too indefinite to furnish an estimate of how much the plaintiff would have benefited had they been performed.[32] In any event, one cannot reasonably read the Wisconsin opinion as referring to these rules. The case dealt with whether promissory estoppel provides some special reason for refusing expectation damages, whereas these rules apply equally to enforcement by estoppel and by consideration. Thus, while *Red Owl* holds that promissory estoppel gives the court discretion to limit damages, the case does not offer the slightest hint how or for what purpose the discretion is to be exercised.

The force of the decision is further weakened because it was unnecessary. The court should have reached the same result on the basis of the established exceptions noted, without addressing promissory estoppel issues. In fact, the case repeatedly mentions the insufficiency of the evidence for estimating expectation damages.[33] In addition, the defendant's broken promises were too indefinite to provide a basis for awarding expectation damages. The defendant specified to the plaintiff neither the exact nature and location of the store nor the precise amount of money the plaintiff would have to provide. The court might have settled the question of damages by determining the figure upon which the plaintiff initially relied to invoke promissory estoppel. The court, however, did not attempt to make such a determination. The question of the nature and location of the store presumably could not have been answered at all because the parties' relationship had ended before a particular store had been identified. Thus, even if the defendant's promises had been supported by consideration, the court would have had no choice but to limit damages in precisely the way it did. Nevertheless, *Red Owl* is cited in eight contracts casebooks as authority for limiting damages

31 E. FARNSWORTH, *supra* note 1, § 12.15, at 881-82.

32 JOHN D. CALAMARI & JOSEPH M. PERILLO, THE LAW OF CONTRACTS § 2.9 (3d ed. 1987).

33 *Red Owl*, 26 Wis. 2d at 697-701, 133 N.W.2d at 274-76.

in a promissory estoppel case.[34]

In *RCM Supply Co. v. Hunter Douglas, Inc.*,[35] the United States Court of Appeals for the Fourth Circuit reversed the district court's judgment for RCM, which had been based on promissory estoppel. RCM sought and obtained from Hunter Douglas a promise to give it a franchise to distribute aluminum siding on condition it build a warehouse and otherwise expand its operations to accommodate the required stock of siding. Before Hunter Douglas gave RCM the distributorship, disputes and disagreements developed between the two companies, and Hunter Douglas refused to go forward with its promise.

The Fourth Circuit reversed the district court's judgment in favor of RCM on the ground that RCM unreasonably relied on the promise of Hunter Douglas.[36] That promise was oral, and RCM spent nearly one million dollars in reliance on it. That sort of unreasonable reliance, the court held, "cannot support recovery under principles of promissory estoppel."[37]

This reasoning is illogical. The court never questioned the nature of the plaintiff's reliance, which apparently was exactly the kind of reliance that a reasonable person under the circumstances would expect.[38] The only fault the court found was with the plaintiff's excessive amount of reliance. Thus, under the court's reasoning, the plaintiff was denied all recovery for relying too much!

The court's opinion, however, did not stop there. It went on to say, in dictum, that the district court had incorrectly used the reliance measure of damages. All the evidence of damages concerned the profits that RCM could have expected to make if Hunter Douglas had kept its promise. These would have been appropriate under the expectation measure, but "[d]amages recoverable under a claim of detrimental reliance are carefully circumscribed; the plaintiff may recover only those specific expenditures made in reliance upon the

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34 J. DAWSON, W. HARVEY & S. HENDERSON, *supra* note 23, at 271, 404-10; E. FARNSWORTH & W. YOUNG, *supra* note 23, at 233-37; ROBERT W. HAMILTON, ALAN SCOTT RAU & RUSSELL J. WEINTRAUB, CASES AND MATERIALS ON CONTRACTS 485-96 (1984); F. KESSLER, G. GILMORE & A. KEONMAN, *supra* note 23, at 223-24; C. KNAPP & N. CRYSTAL, *supra* note 23, at 217-27, 918-19; EDWARD J. MURPHY & RICHARD E. SPEIDEL, STUDIES IN CONTRACT LAW 288-96 (3d ed. 1984); J. MURRAY, *supra* note 23, at 292-302; R. SUMMERS & R. HILLMAN, *supra* note 23, at 302-05, 461; *see also* L. FULLER & M. EISENBERG, *supra* note 23, at 500-08 (includes the case but does not explicitly address the damages issue); ROBERT E. SCOTT & DOUGLAS L. LESLIE, CONTRACT LAW AND THEORY 161, 172-79 (1988) (same).

35 686 F.2d 1074 (4th Cir. 1982).

36 *Id.* at 1078.

37 *Id.*

38 *Id.* at 1075, 1078 (plaintiff was told to expand its lines of siding, which is exactly what it did).

defendant's promise."[39] The court's citation of authority for this last statement makes so little sense that I can only quote it:

> The damage award must be reduced by "the value of any benefits . . . derived from the [expenditures]," *Allied Equip. Co. v. Weber Engineered Prods., Inc.*, 237 F.2d 879, 882 (4th Cir. 1956), and by any unavoidable loss suffered by plaintiff without regard to the defendant's conduct. Restatement (Second) of Contracts § 349 (1981).[40]

This quotation obviously deals with mitigation of damages, not with limitation by the reliance measure in a promissory estoppel case.[41] The court should have used the mitigation principle to limit RCM's recovery to the amount of reliance that Hunter Douglas could reasonably have foreseen when it made its promise. The appropriate resolution of the case then would have been to affirm the judgment for RCM, but remand to the district court for a recalculation of damages in accordance with the mitigation principle.

RCM therefore offers no precedential support for the proposition that estoppel damages are limited by the reliance measure, although it does include nonpersuasive dictum so stating,[42] which is more than can be said for the first two cases. Ironically, only one contracts casebook includes *RCM*.[43] In sum, none of the cases used as precedent for the proposition that damages are limited to the reliance measure in an estoppel case actually is such a precedent, and the only one that supports the proposition, albeit by dictum, does so illogically.

C. Commentators Urging that Damages Be Limited in an Estoppel Case

1. *Arguments Resting on Categorizing Promissory Estoppel as a Tort*

Orvill C. Snyder argued in 1949 that courts should not adopt promissory estoppel as a grounds of enforcement because bargained consideration was "the essence of contract."[44] Also, the

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39 *Id.* at 1079.

40 *Id.* at 1079 n.8.

41 The court's reference to "any unavoidable loss" makes sense only on the assumption that it is meant to refer to *Restatement (Second)* § 350, which deals with the disallowance of avoidable losses. "Avoidability of losses" is the term used in the *Restatement (Second)* for the mitigation principle. *See id.*

42 This dictum is weak even as dictum, however, because the authority the *RCM* court cited for it is irrelevant. At this point, the court seems literally not to have known what it was talking about.

43 THOMAS D. CRANDALL & DOUGLAS J. WHALEY, CASES, PROBLEMS AND MATERIALS ON CONTRACTS 399 (1987).

44 Orvill C. Snyder, *Promissory Estoppel as Tort*, 35 IOWA L. REV. 28, 31 (1949).

"primary" wrong to be rectified in an estoppel situation was a person's detrimental reliance, not his failure to obtain the benefits of performance of a promise.[45] Warren A. Seavey made essentially the same argument in 1951. Seavey traced the genesis of promissory estoppel and showed, to his satisfaction anyway, that it was "basically a tort doctrine" and did not belong in the law of contracts.[46] Seavey argued:

> The wrong is not primarily in depriving the plaintiff of the promised reward but in causing the plaintiff to change position to his detriment. It would follow that the damages should not exceed the loss caused by the change of position, which would never be more in amount, but might be less, than the promised reward.[47]

Grant Gilmore's *The Death of Contract*[48] maintained in 1974 that contract law was "dying" because the bargain principle was being both weakened by exceptions and replaced by reliance, which Gilmore regarded as inherently sounding in tort. The enforcement of promises without proof of consideration weakened contract law. Tort replaced contract law to the extent that promissory estoppel replaced consideration.[49] Gilmore does not deal with the remedy for promissory estoppel; but, since his thesis is premised on promissory estoppel sounding in tort, he should logically be grouped with Snyder and Seavey as an advocate of limiting the remedy to the reliance measure on the ground that such is the appropriate remedy for a tort.

Randy E. Barnett claimed in 1984[50] to have found a "tension" between bargain and reliance in that only the former leaves a person free to bind himself, or not, as he chooses. Barnett therefore connected the bargain principle, but not the reliance principle, with freedom of contract. The basis of the claim is that the bargain principle allows a promisor's intentions to determine his liability, whereas reliance rests liability on blameworthiness which is not necessarily linked to a promisor's intentions. According to Barnett, it therefore follows that courts should normally reserve the expectation measure of damages, which fully enforces a promise, for promises supported by consideration. Courts should award a tort measure of damages (*i.e.*, the reliance measure) only when the promise did not constitute part of a bargain, but was made enforcea-

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45 *Id.* at 32.

46 Warren A. Seavey, *Reliance upon Gratuitous Contracts or Other Conduct*, 64 HARV. L. REV. 913, 926 (1951).

47 *Id.*

48 GRANT GILMORE, THE DEATH OF CONTRACT (1974).

49 *Id.* at 87-92.

50 Randy E. Barnett, *Contract Scholarship and the Reemergence of Legal Philosophy* (Book Review), 97 HARV. L. REV. 1223, 1241 (1984).

ble solely by reliance.[51]

All of these arguments founder on at least two grounds. First, although factual estoppel sounded in tort, it does not follow that promissory estoppel must, or should, also sound in tort. On the contrary, the nature of promissory estoppel clearly makes it a part of the law of contract. The subject of contract law is contracts, which are by definition promises or sets of promises the law will enforce.[52] Promissory estoppel concerns the enforcement of a promise on the grounds of reliance.

The second fallacy lies in the description of the wrong being rectified as that of causing the plaintiff to change his position to his detriment. If this were true, it would mean that it was wrongful—tortiously wrongful—to make promises upon which others foreseeably might rely to their detriment. This would lead to absurd results. People make such promises everyday, especially in business contexts. Surely there is nothing wrongful in their doing so, nor would we want to discourage the practice by making it tortious.[53] The wrong, rather, is in not performing the promise after the promisee has relied upon it to his detriment. And the only measure of damages that is designed to compensate for this wrong is the expectation measure.

Barnett's argument is also confused in its use of intentionality and blameworthiness. Barnett regards promises supported by consideration as intentionally binding, because the promisor knows that when he accepts the consideration, he thereby makes his promise binding.[54] Supposedly, no such intention necessarily exists for a promise made binding only by the promisee's reliance. But promissory estoppel makes a promise binding only if the promise is one "which the promisor should reasonably expect to induce action or forbearance of a definite and substantial character . . . ."[55] That which one reasonably expects to occur as a result of one's actions is an *intended* result of those actions.[56] Barnett's attempted distinction on the basis of intention, therefore, is not well grounded. The promisor whose promises are made enforceable by promissory estoppel has intended the promisee's reliance, just as the promisor

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51 *Id.* at 1241.

52 RESTATEMENT (SECOND), *supra* note 3, § 1.

53 Imagine making it a tort, for example, for a delivery service to promise next-day delivery anyplace in the country, if one should reasonably expect that people would rely on it!

54 Barnett, *supra* note 50, at 1242.

55 RESTATEMENT (FIRST), *supra* note 2, § 90. RESTATEMENT (SECOND), *supra* note 3, § 90 is to the same effect.

56 W. PAGE KEETON, DAN B. DOBBS, ROBERT E. KEETON & DAVID G. OWEN, PROSSER AND KEETON ON THE LAW OF TORTS 34, 36, 169-70 (5th ed. 1984).

whose promise is made enforceable by consideration has intended the consideration. Whether either also intends his promise to be enforceable is a question the law of contract does not ask. Barnett's attempted distinction on the basis of blameworthiness is similarly unsound. It is equally blameworthy not to perform one's promises whether they are made enforceable by consideration or by foreseeable detrimental reliance. The blameworthiness derives from the promise and also perhaps from its being enforceable, not from the character of the grounds making it enforceable.

Barnett has done a good deal of work on promissory estoppel and reliance in contract law. He has published two more pieces on these subjects since the work I have just criticized, one of them with Mary E. Becker.[57] He does not appear to have changed his position, still regarding promissory estoppel as standing somewhere between tort and contract, with a foot in both.[58] Although his analysis of the decisions leads him to say that "in most cases . . . liability [under promissory estoppel] can be understood as contractual in the broad sense that the promisor apparently intended to assume a legal obligation under an objective standard,"[59] he is careful to distinguish this conclusion from his normative beliefs.[60] In a descriptive piece that Becker wrote independently, she also concludes that courts have awarded expectation rather than reliance damages in promissory estoppel cases "consistently and routinely,"[61] not only in commercial situations[62] but also in purely donative situations.[63]

2. *Arguments Resting on a Desire for Symmetry between the Remedy and the Grounds of Enforcement*

All of the above positions seem to derive from an aesthetic of symmetry, although none explicitly admits it. The aesthetic of symmetry matches the reliance enforcement rationale with the reliance measure of damages. This symmetry may have a certain appeal, but its logic does not withstand even the most superficial analysis. The expectation remedy does not match the rationale for enforcement with the measure of damages. If it did, the remedy for a breach of a promise would be simply the return of the consideration. Symme-

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57 Randy E. Barnett, *A Consent Theory of Contract*, 86 COLUM. L. REV. 269 (1986); Randy E. Barnett & Mary Becker, *Beyond Reliance: Promissory Estoppel, Contract Formalities, and Misrepresentation*, 15 HOFSTRA L. REV. 443 (1987).

58 Barnett & Becker, *supra* note 57, at 443, 445-46.

59 *Id.* at 496.

60 *Id.* at 446.

61 Mary E. Becker, *Promissory Estoppel Damages*, 16 HOFSTRA L. REV. 131, 136 (1987).

62 *Id.* at 140-55.

63 *Id.* at 135-40.

try, if carried to its logical conclusion, would eliminate the expectation measure as the remedy in *every* case.

3. *Arguments Implicitly Equating Promissory Estoppel with a Duty to Bargain in Good Faith*

Another argument implicit in the above positions is that expectation damages in some estoppel cases would overcompensate plaintiffs and deter generally beneficial conduct. This argument is implied in the characterization of *Red Owl* as a case recoguizing a duty of "good faith bargaining."[64] Under this interpretation, the defendant committed a wrong when he failed to bargain in good faith. If there is a duty of good-faith bargaining, then it derives from tort; therefore, the appropriate remedy should equal the amount of the victim's reliance. This view sees expectation damages as overcompensating the plaintiff because bargaining in good faith does not guarantee that a contract will result. This view further disapproves of awarding expectation damages in such cases because excessive damages would ultimately deter good-faith bargaining: bargainers would have to act overcautiously not to expose themselves to substantial liability.

This argument is flawed because it equates promissory estoppel with a duty of good-faith bargaining. Promissory estoppel operates only if there has been a promise, foreseeably relied upon by a promisee. Bargaining, as such, does not involve promises. It is implicitly understood that the "promises" either side offers do not actually become promises unless and until the deal is made. What distinguishes bargaining in good faith from bargaining in bad faith is not a question to be thoroughly pursued here, but one distinction might be a secret intent on one side never to reach an agreement. This party might, for example, hope to induce the other to waste time and money in order to reduce its effectiveness as a business competitor. This kind of bad-faith bargaining would not necessarily involve any promises. The appropriate measure of damages would therefore be the victim's reliance. Indeed, the expectation measure *could not* be applied, because there would be no promises by which to determine the promisee's expectation. Nor is promissory estoppel capable of being applied to bad-faith bargaining as such, since it requires reliance on a promise.

The argument also misinterprets *Red Owl*, although this is not a matter of great importance. The Wisconsin Supreme Court clearly found as fact that the defendant promised the plaintiff a franchise if he trained with defendant and came up with the stated amount of

64 *See* E. FARNSWORTH, *supra* note 1, § 3.26, at 191-92.

money. However, if the *Red Owl* court did *not* think the defendant had made such a promise, it lacked one of the essential elements of promissory estoppel—a promise—and so ought not to have applied it. The case then *is* precedent for the existence of a duty to bargain in good faith, but one in which the court confused this duty with promissory estoppel.

4. *Arguments Implicitly Equating Promissory Estoppel with the Enforcement of Donative Promises*

Melvin Aron Eisenberg recommends that the remedy under section 90 should normally be limited to the reliance measure because this ought to be the measure of damages if a promisee relies upon a donative promise. He defines a donative promise as a promise to confer a benefit by gift.[65] Eisenberg's arguments for thus limiting the remedy for breaches of donative promises are persuasive; however, his implicit assumption that section 90 is limited to enforcing relied-upon donative promises is wide of the mark. The section is not so limited in either *Restatement*. The promises in *Goodman*, *Red Owl*, and *RCM* were not donative.[66] In fact, it is difficult to find any promissory estoppel cases in which the promises were donative. The only case I know of in which the court limited section 90 to donative promises is *Baird v. Gimbel*, which, as mentioned earlier, has never been followed.[67]

Eisenberg's recommendation is overinclusive since his reasons for limiting the section 90 remedy are themselves limited to donative promises. In another respect, his argument is underinclusive. He assumes not only that no promises other than donative promises are made enforceable by section 90, but also that no donative promises are made enforceable by consideration. This is simply untrue. The doctrine of consideration includes a rule that a court will not inquire into the adequacy of the amount.[68] This rule permits largely donative promises to be made binding by consideration. The consideration is deliberately set at an amount that is inadequate, which makes the promise donative to the extent of the inadequacy. For example, parents sometimes sell their home to a child at a price just over what it costs them to pay off the mortgage and their moving expenses to a retirement community.[69] If donative promises are to be subject to lesser enforcement, therefore, this rule must include some means of distinguishing them from promises that

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65 Melvin Aron Eisenberg, *Donative Promises*, 47 U. CHI. L. REV. 1, 1 (1979).

66 *See supra* notes 13-42 and accompanying text.

67 *See supra* note 11 and accompanying text.

68 E. FARNSWORTH, *supra* note 1, § 2.11.

69 *See* RESTATEMENT (SECOND), *supra* note 9, § 90 comment d.

are not donative. But contrary to what Eisenberg evidently thinks, an absence of consideration proves neither that a promise is donative nor that it is not.

D. *The Restatement (Second) of Contracts*

Section 90 of the *Restatement (Second)* was changed from its form in the *Restatement (First)* to provide explicitly that the remedy in a promissory estoppel case "may be limited as justice requires."[70] This possibility is dealt with in comment d, which begins:

> *Partial enforcement.* A promise binding under this section is a contract, and full-scale enforcement by normal remedies is often appropriate. But the same factors which bear on whether any relief should be granted also bear on the character and extent of the remedy. In particular, relief may sometimes be limited to restitution or to . . . reliance rather than by the terms of the promise. See §§ 84, 89; compare Restatement, Second, Torts § 549 on damages for fraud. . . .[71]

When there is a substantive change in one of the sections in a new edition of a Restatement, one would expect the change to be supported either by changes in the law itself (as in judicial decisions since the publication of the previous edition) or by principles and policies sufficiently persuasive to justify an exception to established law. And in this case, there is a third expectation. Since the change in section 90 has the effect of providing courts discretion to limit damages in estoppel cases, section 90 should also provide guidance as to how the discretion is to be exercised. Section 90, however, meets none of these expectations. The decisions cited in support of the change do not, in fact, support it. Not one principle or policy is stated to explain it. No guidance on how one is to exercise the discretion is offered.

The first sentence of comment d is both puzzling and uninformative. If a promise made binding under this section is a contract, one would expect that "full-scale enforcement by normal remedies" would always, or at least normally, be appropriate. The sentence is uninformative in any event, because it does not state *when* such enforcement is appropriate. The second sentence is equally unenlightening, because nothing in section 90 or in the other sections it references sets forth the "factors which bear on whether any relief should be granted . . . ." Section 84 deals with promises to perform a duty despite nonoccurrence of a condition. Section 89 deals with modification of an executory contract. Neither has anything more to

70 *Id.* § 90.
71 *Id.* § 90 comment d.

do with promises made enforceable by reliance than with promises made enforceable by consideration. The same is true of the section referred to in the *Restatement (Second) of Torts*.

Comment d includes Illustrations 8 through 12. Illustration 8[72] is based on *Goodman v. Dicker*.[73] Illustration 10[74] is based on *Red Owl*.[75] After noting that Illustration 8 is based on *Goodman*, the Reporter's Note directs the reader to "cf."[76] *Terre Haute Brewing Co. v. Dugan*.[77] In *Terre Haute* the court excluded lost profits from the plaintiff's recovery, not for reasons related to promissory estoppel, but because it found the contract void for want of mutuality.[78] The court then followed the void-for-mutuality rule of agency law, and limited an agent's recovery of expenses incurred in reliance upon his principal to those which he had not had time to recoup before the principal discharged him. The *Terre Haute* court never mentioned promissory estoppel.

Illustration 9[79] is based on *Chrysler Corp. v. Quimby*.[80] Both in

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72 *A* applies to *B*, a distributor of radios manufactured by *C*, for a "dealer franchise" to sell *C*'s products. Such franchises are revocable at will. *B* erroneously informs *A* that *C* has accepted the application and will soon award the franchise, that *A* can proceed to employ salesmen and solicit orders, and that *A* will receive an initial delivery of at least 30 radios. *A* expends $1,150 in preparing to do business, but does not receive the franchise or any radios. *B* is liable to *A* for the $1,150 but not for the lost profit on 30 radios.

RESTATEMENT (SECOND), *supra* note 3, § 90, illustration 8. *Compare* RESTATEMENT (SECOND) AGENCY § 329.

73 *See supra* notes 18-23 and accompanying text.

74 *A*, who owns and operates a bakery, desires to go into the grocery business. He approaches *B*, a franchisor of supermarkets. *B* states to *A* that for $18,000 *B* will establish *A* in a store. *B* also advises A to move to another town and buy a small grocery to gain experience. *A* does so. Later *B* advises *A* to sell the grocery, which A does, taking a capital loss and foregoing expected profits from the summer tourist trade. *B* also advises *A* to sell his bakery to raise capital for the supermarket franchise, saying "Everything is ready to go. Get your money together and we are set." *A* sells the bakery taking a capital loss on this sale as well. Still later, *B* tells *A* that considerably more than an $18,000 investment will be needed, and the negotiations between the parties collapse. At the point of collapse many details of the proposed agreement between the parties are unresolved. The assurances from *B* to *A* are promises on which *B* reasonably should have expected *A* to rely, and *A* is entitled to his actual losses on the sales of the bakery and grocery and for his moving and temporary living expenses. Since the proposed agreement was never made, however, *A* is not entitled to lost profits from the sale of the grocery or to his expectation interest in the proposed franchise from *B*.

RESTATEMENT (SECOND), *supra* note 3, § 90, illustration 10.

75 *See supra* notes 24-34 and accompanying text.

76 RESTATEMENT (SECOND), *supra* note 3, § 90, Reporter's Note.

77 102 F.2d 425 (8th Cir. 1939).

78 *Id.* at 427.

79 The facts being otherwise as stated in Illustration 8, *B* gives *A* the erroneous information deliberately and with *C*'s approval and requires *A* to buy

the illustration and in *Quimby*, lost profits *were* granted. In the course of deciding the appropriate remedy, the *Quimby* court quoted Fuller and Perdue: "Courts have, in fact, done at least four different things about promises which have given rise to unbargained-for reliance: (1) nothing, (2) granted restitution, (3) reimbursed the promisee's losses through reliance, (4) secured for the promisee the expectancy or its value."[81] The court then stated that "all these possibilities are recognized in the Restatement [First] except the third."[82] Thus, *Quimby* held that promissory estoppel, as stated in the *Restatement (First)*, did *not* allow a court to limit damages to the reliance measure, even in its discretion!

After noting that Illustration 10 is based on *Red Owl*,[83] the Reporter's Note directs the reader to "[s]ee also"[84] *Janke Construction Co. v. Vulcan Materials Co.*[85] This federal district court sitting in Wisconsin followed Wisconsin law as it understood it from *Red Owl*, as the United States Constitution requires.[86] It is difficult to imagine how this was thought to support the change in the section.

Illustration 11[87] is said to be based on *Miller v. Lawlor*.[88] This case concerns a court's equitable discretion whether to grant specific performance (which it did in this instance), not whether to grant expectation or reliance damages under promissory estoppel.[89] Finally, Illustration 12[90] is said to be based on *Kauffman v.*

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the assets of a deceased former dealer and thus discharge *C*'s "moral obligation" to the widow. *C* is liable to *A* not only for *A*'s expenses but also for the lost profit on 30 radios.

RESTATEMENT (SECOND), *supra* note 3, § 90, illustration 9. For text of Illustration 8, see *supra* note 72.

80 51 Del. 264, 144 A.2d 123, *reh'g denied*, 51 Del. 295, 144 A.2d 885 (1958).

81 *Id.* at 283, 144 A.2d at 133-34 (quoting Lon L. Fuller & William R. Perdue, Jr., *The Reliance Interest in Contract Damages*, 46 YALE L.J. 373, 405 (1937)).

82 *Id.*

83 RESTATEMENT (SECOND), *supra* note 3, § 90, Reporter's Note.

84 *Id.*

85 386 F. Supp. 687 (W.D. Wis. 1974), *aff'd*, 527 F.2d 772 (7th Cir. 1976).

86 Erie Railroad Co. v. Tompkins, 304 U.S. 64, 79-80 (1938).

87 *A* is about to buy a house on a hill. Before buying he obtains a promise from *B*, who owns adjoining land, that *B* will not build on a particular portion of his lot, where a building would obstruct the view from the house. *A* then buys the house in reliance on the promise. *B*'s promise is binding, but will be specifically enforced ouly so long as *A* and his successors do not permanently terminate the use of the view.

RESTATEMENT (SECOND), *supra* note 3, § 90, illustration 11.

88 245 Iowa 1144, 66 N.W.2d 267 (1954).

89 *Id.* at 1155-56, 66 N.W.2d at 274-75.

90 *A* promises to make a gift of a tract of land to *B*, his son-in-law. *B* takes possession and lives on the land for 17 years, making valuable improvements. *A* then dispossesses *B*, and specific performance is denied because the proof of the terms of the promise is not sufficiently clear and definite. *B* is entitled to a lien on the land for the value of the improvements, not exceeding their cost.

Miller.[91] The reader is also directed to "cf." *Aiello v. Knoll Golf Club*,[92] and to "see" various A.L.R. annotations.[93]

In *Kauffman* a son-in-law sued his father-in-law, demanding an accounting of improvements the son-in-law made on land that belonged to the father-in-law and that the father-in-law had promised would be willed to the son-in-law. The father-in-law changed his mind and had the son-in-law ejected from possession. The court granted the accounting, apparently on a theory of unjust enrichment.[94] No mention was made of promissory estoppel or of the appropriate measure of damages.

Like *Kauffman*, *Aiello* was a suit by a person in possession for an accounting for improvements, against an owner who had revoked his oral promise to give the land to the possessor. The court found for the owner on the grounds that his promises had not induced the possession to make the improvements.[95] Although the court mentioned in applying the "doctrine of parol gift"[96] that the doctrine was "based upon the reliance of the transferee on the representations of the promisor—a form of promissory estoppel,"[97] there was no mention of limiting damages.

The cited A.L.R. annotations concern the specific performance of oral promises to convey real property,[98] the enforceability of such promises,[99] and the "[m]easure and items of recovery for improvements mistakenly placed or made on land of another."[100]

Thus, of the five illustrations accompanying comment d, three rest on cases irrelevant to the "partial enforcement" of promises made enforceable by estoppel, one rests on a case that holds that a court has no discretion to limit damages on that account, and one rests on *Red Owl*. The three cases that comment d indirectly cited[101] also offer no support, and none of the secondary authorities cited even bears on the subject of partial enforcement under promissory

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RESTATEMENT (SECOND), *supra* note 3, § 90, illustration 12.

91 214 Ill. App. 213 (1919).

92 64 N.J. Super. 156, 165 A.2d 531 (1960).

93 RESTATEMENT (SECOND), *supra* note 3, § 90, Reporter's Note. *See* Annotation, *Measure and Items of Recovery for Improvements Mistakenly Placed or Made on Land of Another*, 24 A.L.R.2d 11 (1952); Annotation, *Comment Note—Parol Gift of Realty*, 155 A.L.R. 76 (1945); Annotation, *Doctrine of Part Performance in Suits for Specific Performance of Parol Contract to Convey Real Property*, 101 A.L.R. 923, 985 (1935).

94 *Kauffman*, 214 Ill. App. at 216-17.

95 *Aiello*, 64 N.J. Super. at 164-66, 165 A.2d at 535-36.

96 *Id.* at 160, 165 A.2d at 533.

97 *Id.* at 163, 165 A.2d at 535.

98 101 A.L.R. 923, 985 (1936).

99 155 A.L.R. 76 (1945).

100 24 A.L.R.2d 11 (1952).

101 *Terre Haute*, *Aiello* and *Janke Construction*.

estoppel. So, with the possible exception of *Red Owl*, the attempt of *Restatement (Second)* to support the change in section 90 is specious, and the validity even of *Red Owl* as authority for this purpose is doubtful.

The lack of any judicial or scholarly authority would not be problematic if the Restatement presented any reasoned arguments supporting section 90, but none is offered. Not only is the Restatement's discretion for limiting the damages in an estoppel case unsupported by either reason or authority, it is badly conceived. It is discretion without principle or purpose. The only purpose stated is "to do justice," but every rule of common law is supposed to do justice. In any event this admonition fails to explain why limiting the remedy is more necessary to justice in an estoppel case than in a case resting on consideration.

There is, however, an evident purpose for exercising the discretion in one particular situation. The *Restatement (First)* made a relied-upon promise enforceable only if the reliance was "of a definite and substantial character." The *Restatement (Second)* dropped this condition. The discretion for limiting the remedy, therefore, might be exercised to reduce the remedy to a recovery of the amount of the reliance when the amount was thought to be too small to justify enforcing the promise by awarding the expectation measure of damages.[102] Nothing in the official illustrations or comments to section 90 suggests that this was the intended purpose of the discretion, but some statements at the very beginning of the Reporter's Note clearly indicate it:

> The principal change from former § 90 is the recognition of the possibility of partial enforcement. . . . *Partly* because of that change, the requirement that the action or forbearance have "a definite and substantial character" is deleted . . . .[103]

This is indeed a sensible purpose, but it does not purport to be the only purpose and therefore does not remove the arbitrariness of the discretion. Since the purpose of limiting the damages to the promisee's reliance is applicable only where the reliance is very small relative to the value of the promise, this purpose has no general application. Since there are still other unnamed purposes, the discretion remains unbounded.

II. THE INADEQUACIES OF THE RELIANCE MEASURE

All the commentators mentioned in Part II urged the limitation

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102 For reasons why the expectation measure is the only measure that can logically be said to enforce the promise, see *infra* note 104-09 and accompanying text.

103 RESTATEMENT (SECOND), *supra* note 3, § 90, Reporter's Note (emphasis added).

of damages to the reliance measure in estoppel cases while ignoring the results that could be expected in terms of compensation, deterrence, and other aspects of conduct. This is a serious mistake. Although there are exceptions, the results of generally using the reliance measure in estoppel cases are both substantial and unjust. Analysis of the expectation measure shows it to be superior to the reliance measure in virtually every respect.

A. Inadequate Compensation in Principle

The compensation principle underlies virtually every law in which damages entitlements exist. The principle states that damages must be sufficient to put the injured party in as good a position as he would have been had he not been wrongfully injured. One step in applying the compensation principle is identification of the wrong. This requires that one identify the conduct that ought to be deterred and for which a person who injures another in the course of that conduct deserves liability to the injured party as punishment. A second step is to measure the extent of the resultant injury. This measurement is necessary to the calculation of the amount that will restore the injured party to as good a position as if the wrong had not been done. As applied in a tort case such as an automobile accident, the principle identifies careless driving as the conduct to be deterred and for which punishment by way of liability is justified. It then dictates that damages be sufficient to restore the victim's person and property to their pre-accident condition.

The wrong in a contract case is the failure to perform the promise. This failure to perform is the conduct we seek to deter or punish by imposing liability. As a rule, deterrence in a contract case is supposed to be only conditional; a party is entitled to breach if he fully compensates the other party for the injuries that result. This qualification is introduced by the efficiency principle, which is discussed below.[104] It does not eliminate the deterrence purpose from the compensation principle in contract law; it merely qualifies it. The amount of damages is set by the expectation measure, because this is the amount required to put the injured party in as good a position as if the promise had been performed. Thus, the expectation measure *is* the compensation principle applied to contracts. This application logically applies equally to all contracts, whatever their basis. It therefore applies just as much to a promissory estoppel case as it does to a consideration case.

The only way the reliance measure can be made to fit this compensation principle is to regard the wrong not as the failure to per-

104 *See infra* notes 131-33 and accompanying text.

form the promise, but as the making of the promise in the first place, at least if it were reasonably foreseeable that people would rely on it. This construction must be rejected as contrary to the mores and practices of our society. As a rule, promising is not wrongful conduct. We do not want to deter promising, and we do not want to hold people who promise liable to those who rely on their promises. Relying on a promise is not an injury in itself; it becomes one only if the promise is not performed. On the contrary, the ability to make and rely upon promises is an enormous benefit in a society like ours. The economy requires the making and keeping of numerous promises in order to function efficiently, and the social fabric is knit together with promises. Acts and events as diverse as marriage ceremonies, oaths of office, oaths of church membership, and children's games consist of promises in significant part.[105]

A common example that illustrates how gross an undercompensation reliance damages can be, even when reliance is the basis of enforcement, can be drawn from the insurance industry. Life insurers customarily promise to provide life insurance as of the moment the insurer receives the application, even if they subsequently decide to reject the application on the grounds of an unsatisfactory medical examination. The applicant either gets a full refund of anything he paid if his application is rejected, or he is not required to pay anything until it is accepted.[106] There is certainly no consideration for the insurer's promise in the latter case and probably not in the former. Promissory estoppel, however, would ordinarily make the promise enforceable by or on behalf of the person's beneficiaries should the person die during the interim period. But if reliance were the measure of damages, the beneficiaries would recover at most the premium and the applicant's expenses for a medical examination. Then again, they might receive nothing at all because, as beneficiaries, they had expended nothing in reliance.[107] Only under the expectation measure would they be entitled to the amount of the insurance.

There is a situation for which the reliance measure is appropriate, but it is not a breach of contract situation. When a person makes a contract on the basis of a mistake of fact, and the other party acts in reliance on the situation, it is logical to view the wrong

105 To repeat the example given earlier: to count the making of the promise rather than the failure to perform it as the wrong logically requires us to count as wrongful the promises that are regularly made by commercial delivery services to deliver packages no later than the next day—at least if it were reasonably foreseeable that people would rely on the promises by using the delivery services of those providers.

106 II ROBERT H. JERRY, UNDERSTANDING INSURANCE LAW § 33 (1987).

107 The beneficiaries presumably would be entitled to enforce the promise as third party beneficiaries even though the reliance that made it enforceable was the decedent's.

as the mistake rather than as the failure to perform the contract based on it. The law generally allows the mistake-making party to withdraw from the contract if he promptly notifies the other party of the mistake upon discovering it, and the mistake-making party compensates the other party for any material interim reliance. This is known as the "unilateral mistake" doctrine.[108]

It would be superficial to confuse the unilateral mistake doctrine with the reliance measure for breach of contract. The doctrine of unilateral mistake *excuses* the mistake-making party from the contract. It does not conceive of him as breaching it. Nor does anything in the doctrine or its application depend on whether the contract rests on consideration or reliance. The mistake doctrine has been applied in both instances.[109]

B. Additionally Inadequate Compensation in Practice

Even by their own measure, reliance damages undercompensate in practice. After breach, putting the injured party in as good a position as if the contract had never been made usually requires a determination of what other contracts would have been made. The same reasons that impelled the making of the breached contract presumably would have impelled the injured party to make others of a similar nature had he not made the breached one. In *Goodman*, *Red Owl*, and *RCM*, for example, the breached contracts all involved the giving of franchises.[110] The plaintiffs in each case presumably would have made franchise agreements with other franchisors or, at least, would have been engaged in gainful employment had they not entered these particular arrangements.

Yet, sufficiently certain evidence of what these other arrangements would have been is almost sure to be lacking. Reliance measure damages therefore almost always rest, in practice, on the unrealistic assumption that the plaintiff would have done nothing—at least nothing profitable—had the breached contract not been made. The plaintiff, as a result, is not really placed in as good a position as if the contract had not been made. He is actually compensated only for his out-of-pocket expenses and receives nothing for his lost opportunities.[111]

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108 E. FARNSWORTH, *supra* note 1, § 9.4.

109 *See id.*

110 Goodman v. Dicker, 169 F.2d 684, 684 (D.C. Cir. 1948); Hoffman v. Red Owl Stores, 26 Wis. 2d 683, 687, 133 N.W.2d 267, 269 (1965); RCM Supply Co. v. Hunter Douglas, Inc., 686 F.2d 1074, 1075 (4th Cir. 1982).

111 Robert Cooter & Melvin Aron Eisenberg, *Damages for Breach of Contract*, 73 CALIF. L. REV. 1434, 1461-62 (1985), makes the same point.

This is not the end of the difficulties, however.[112] Even if a plaintiff could prove with reasonable certainty the profits he would have made on his lost opportunities, these profits could not be fully counted in computing his reliance damages. The profits on each such lost opportunity must be discounted by the probability that the promises concerned would not have been kept. If those promises would not have been kept, the plaintiff has no greater entitlement to those lost profits than to the profits he lost by relying on the defendant's promise. He would only be entitled to his out-of-pocket reliance expenditures.[113]

This last point also answers an argument sometimes made in support of the reliance measure generally.[114] The argument acknowledges the difficulties of proof of lost opportunities and asserts that when these difficulties would be too great, the plaintiff should be allowed to use the expectation measure because it provides a rough approximation of the profits that would have been made on the lost opportunities. Under existing law, however, the reliance measure is used to supplement the expectation measure when proof of expectation is difficult.[115] Alternatively, the expectation measure could be used to supplement the reliance measure in cases where proof of reliance would be difficult. But this argument overlooks the point previously made: under the reliance measure, the value of lost opportunities would not amount to the full profits the plaintiff might have made on them.[116]

The facts of *Drennan v. Star Paving Co.*[117] serve as an illustration. The defendant, Star Paving Company, made a bid to do the paving work on a construction job for a school district. It submitted this bid to several general contractors, including the plaintiff, Drennan. Drennan computed his bid on the basis of Star's bid and submitted it, along with a bond for ten percent of the amount, to the school district. Later, Star notified him that it was withdrawing its bid because it had made a mistake in computing it. Drennan completed the job using a different paving subcontractor, and sued Star for the difference between what he paid the other paving subcontractor and the amount he would have paid Star. The trial court held for Dren-

112 That no one has noticed the additional difficulties I am about to discuss is perhaps explained by the fact that the difficulties I have previously explained so often prove to be insurmountable that the additional difficulties are only rarely encountered.

113 Uuless, of course, he could prove with reasonable accuracy the existence of still more opportunities, which he would have lost had he not taken the opportunities he lost by relying on the first promise, and so on, *ad infinitum*!

114 *See* Fuller & Perdue, *supra* note 81, at 373-76.

115 *See supra* notes 31-32 and accompanying text.

116 *See supra* notes 112-13 and accompanying text.

117 51 Cal. 2d 409, 333 P.2d 757 (1958).

nan, Star appealed, and the Supreme Court of California affirmed on the basis of promissory estoppel. The court held that Star's bid was accompanied by an implicit promise not to withdraw it until Drennan had had a reasonable opportunity to accept it, if he relied on it in bidding for the job and his bid was accepted. This promise was implied by the fact that Star knew, or reasonably should have known, that Drennan would rely on its bid in making its own bid to the school district.[118]

Imagine the difficulties the court would have had determining the reliance damages. If Drennan had not relied on Star's bid, he presumably would have relied on some other paving contractor's, which would not necessarily have been the next lowest. General contractors do not choose their subcontractors solely on the basis of price; they consider other factors like quality and reliability. First, the court would have had to determine which other bid Drennan would have relied upon. The second question would have been how much this would have increased Drennan's own bid. The increase would not necessarily have been the precise amount of the difference between the paving bids, because Drennan might have decided to absorb some of the difference in order to have a better chance of obtaining the construction job.

Third, the court would have had to determine whether Drennan would have been awarded the job if he submitted this higher bid. If Drennan would have received the job, he would not have suffered any damages at all (by the reliance measure) except to the extent of the difference, if any, between the two paving bids he decided to absorb. Furthermore, if he would not have been awarded the job with the higher bid, he not only would have been undamaged (again by the reliance measure), he presumably would have *profited* from Star's conduct. As long as he made *some* profit despite paying more to another paving subcontractor than he would have paid Star, he would be better off having gotten the job than not—unless he could prove that if he had not received the school job, he would have bid on *and been awarded* some other, more profitable job.

Finally, if all the above had been proven with reasonable accuracy, Drennan would still have to prove the probability that the paving subcontractor upon whose bid he would have relied would have reneged on its bid. The total lost profits would then have to be discounted by this probability. This last step, of course, would be required because if the substitute paving contractor had reneged, Drennan would not have been able to recover expectation measure damages from him, either. Star's bid was in fact $7131.60, and

118 *Id.* at 415; 333 P.2d at 760.

Drennan paid another paving contractor $10,948.60.[119] If Drennan would have had to prove all of the above in order to collect anything at all, his lawyer undoubtedly would have advised him to forget it. Any judgment he could have hoped to get would not have covered his legal costs.

C. Inability to Deal with Partial Breaches

A reliance measure fails to provide an adequate remedy for partial failures of performance. This inadequacy results from the reliance measure's failure to measure accurately the harm done by the wrong.[120] The facts of *Red Owl* again serve as an illustration. Suppose that the defendant gave the plaintiff his franchise, but it was less valuable than the defendant had promised. It might be badly located, for example. But if it was still of enough value to the plaintiff to exceed his reliance expenditures, the defendant would owe him nothing by the reliance measure. For this reason, almost all partial failures of performance would go uncompensated. People rarely enter into contracts unless they expect to receive substantially more value from them than what they give in return. Otherwise there would be no point in incurring the transaction costs.

The complete failure to compensate at all for most partial failures of performance would be more than an injustice. It would also have a devastating effect on the incentives for full performance. The facts of *Red Owl* also illustrate this point.[121] Suppose the defendant acknowledged that it had promised the plaintiff a franchise for only $18,000. Also suppose that the plaintiff's reasonably foreseeable reliance on the promise had made it enforceable, so that the defendant would be liable if it did not perform. If the measure of liability were merely the plaintiff's reliance, however, the defendant would have no incentive to give the plaintiff any franchise that was worth more than the amount by which the plaintiff had already relied. Therefore, it could deliver a much less valuable franchise than it had promised, with impunity.

D. Conceptual Confusion

Conduct that gives rise to promissory estoppel is often factually indistinguishable from conduct that gives rise to consideration, where the consideration is the performance requested by an offer for a unilateral contract. This conceptual confusion is harmless so long as the legal consequences of the two doctrines are the same. It

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119 *Id.* at 412; 333 P.2d at 759.

120 *See supra* notes 104-19 and accompanying text.

121 For the facts of *Red Owl*, see *supra* notes 24-30 and accompanying text.

becomes quite harmful, however, when the consequences differ by limiting damages to the reliance measure in the case of promissory estoppel. When a person promises to do something if the promisee does something in exchange (as opposed to only promising to do something in exchange), and the promisee does that something, the result is a contract. The thing done is the consideration that makes the promise enforceable. This is called a "unilateral contract," because there is a promise only on one side.[122] But since the promisor, under these circumstances, also reasonably expects that his promise will induce the promisee to do the thing asked for, the promise is also enforceable under promissory estoppel. If promissory estoppel were to limit the promisee's remedy to the reliance measure, one would either have to overrule more than a century of precedents on unilateral contracts, which have always entitled the promisee to expectation damages, or find some nonexistent basis for distinguishing them from cases of promissory estoppel. Consideration doctrine and promissory estoppel simply overlap in these instances.

Moreover, these instances are not unusual. All three cases discussed earlier—*Goodman*, *Red Owl*, and *RCM*—in which the courts gave only reliance measure damages, were instances of such overlapping. In none of them did the defendant make an unqualified promise of a franchise. In all of them, the promise was conditional on the plaintiff's doing or giving something in exchange. Therefore, they all could have been decided on the ground that the parties had entered unilateral contracts. Established law would then mandate expectation damages (assuming that problems of certainty of proof, definiteness of the promise, etc., could be surmounted). None of the commentators[123] urging that damages be limited to the reliance measure in estoppel cases has explained how to distinguish estoppels from offers for unilateral contracts.

There is a way of avoiding this conceptual confusion, but it has its own difficulties. The alternative method involves its own conceptual confusion, and would limit damages to the reliance measure in only a few types of estoppel cases. This method redefines promissory estoppel as a ground of enforcement available only if all its elements are present and, in addition, if enforcement on the grounds of consideration (on a unilateral-contract theory) is not justified. Thus, all the "overlap" cases would be covered by consideration alone, and promissory estoppel would apply only if the promise is otherwise unenforceable. This is the concept of promissory es-

122 E. FARNSWORTH, *supra* note 1, § 3.5.

123 *See supra* notes 44-69 and accompanying text.

toppel that Judge Learned Hand had in mind in *Baird v. Gimbel*, the 1933 case that was never followed.[124] Under *Baird v. Gimbel*, *Goodman v. Dicker*, *Red Owl*, *RCM*, and virtually all of the other reported decisions using promissory estoppel since the publication of the *Restatement (First)* in 1932 would have been decided differently. Promissory estoppel would apply only if the promise were truly donative, which is to say, made with no expectation of receiving anything in exchange.

Yet, the conceptual confusion this approach encounters is almost as bad as that which it avoids. In any case in which the promise is conditional, the condition must be examined to determine whether it is merely a condition of receiving the benefit of the promise or something that the promisor wants in exchange. If it is the latter, the promisee's performance of the condition constitutes consideration under the unilateral-contract theory, and promissory estoppel is not available. Distinguishing between conditional gift promises and promises made conditional on receiving something in exchange is often very difficult. The facts of the "Sister Antillico"[125] case serve as an illustration. The defendant, upon hearing that his brother had died leaving a widow with two children, informed the widow that he had an empty cabin in which he would let her and her children live. The defendant added that he, a bachelor, was lonely and would enjoy their company. Sister Antillico gave up the farm she had inherited and with her children traveled the long distance to the defendant's farm. Unfortunately, she and the defendant did not get along, and he ejected her and her children two years after their arrival.

All of this happened before promissory estoppel had become law. The court therefore had to decide whether Sister Antillico's giving up her inherited farm and travelling the long distance to the defendant's land was consideration. The court found no consideration and Sister Antillico recovered nothing.[126] The decision turned on whether the defendant had offered her the use of the cabin in exchange for their coming, because he hoped thereby to alleviate his loneliness, or whether she gave up the inherited land and came only as a condition to receiving the benefit of his purely donative promise to give her the use of the cabin. The same determination would have to be made if the case came up today, if promissory estoppel were redefined to apply only to promises not enforceable by consideration. Note, however, that the redefinition affects only the measure of recovery. Sister Antillico would be entitled to expecta-

124 *See supra* notes 11-16 and accompanying text.
125 Kirksey v. Kirksey, 8 Ala. 131 (1845).
126 *Id.* at 133.

tion damages if the defendant's promise was interpreted as asking for an exchange; however, she would be limited to reliance damages if his promise was interpreted as purely donative.

E. Failing to Punish "Overpromising"

The reliance measure imposes no liability for "overpromising." Consider once more the facts of *Red Owl*. The defendant never actually refused to give the plaintiff a franchise. Its failure of performance consisted rather of its first making the valuable and enticing promise of giving the plaintiff a franchise for an investment of only $18,000 and then, step by misleading step, requiring the plaintiff to put up more and more of his own money until the plaintiff found the amount to be more than he could raise.[127] This is "overpromising" because the promisor does not intend to perform his promise as fully, as unqualifiedly or as unconditionally as he has led the promisee to expect. He thus promises *more* than he intends to deliver as a way of inducing the promisee into relying to such an extent that he will be unable to back out. The promisor will then be able to obtain counterperformance from the promisee at much less cost to the promisor than his "overpromising" led the promisee to expect.

"Overpromising," in other words, is the promise of an especially good deal, which the promisor never expects to perform, as a means of maneuvering the promisee into accepting a much worse deal. By the time the promisee realizes he has been manipulated, he will be in too far to back out. The plaintiff in *Red Owl* had been manipulated into agreeing to put up $31,000 of his own money. The defendant then raised the required investment to $34,000, at which point the plaintiff finally gave up. Had the plaintiff agreed to the increase to $34,000, might the defendant's increases have continued? One suspects that the defendant had a number of would-be franchisees whom it was stringing along, and that it finally gave franchises to those from whom it could draw the most blood.

In *Red Owl*, the reliance measure neither compensated the plaintiff for this kind of misleading manipulation nor provided the defendant with an incentive not to engage in it. The plaintiff would not have been entitled to any more damages than he received if the initial promise had been to give him a franchise for only $10,000, for example, because the value of the promise is relevant only under the expectation measure. An unscrupulous person thus has no reason not to "promise the moon" in order to induce the action that he

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127 Hoffman v. Red Owl Stores, Inc., 26 Wis. 2d 683, 687-91, 133 N.W.2d 267, 269-71 (1965).

wants his "sucker" to take, if the amount for which he will be liable will be just the "sucker's" reliance.

One might argue that the law of contract need not be concerned with deterring or compensating for "overpromising," because such behavior constitutes fraud under the law of tort, which already provides sufficient deterrence and compensation. The argument carries very little weight. Promissory fraud is notoriously difficult to prove, because it requires proof that the promisor had no intention to perform when the promise was made. A later change of heart is not enough.[128] Even if fraud is proven, the normal damages are just the defrauded person's reliance. Trne, some jurisdictions allow punitive damages for fraud, but others do not,[129] and still the difficulties of proof remain. It is also true that some jurisdictions allow the defrauded party to "affirm the contract" into which he has been fraudulently induced, thereby entitling him to expectation damages for the contract's breach.[130] But if damages for breach of a contract made enforceable by promissory estoppel were limited to the reliance measure, "affirming" the contract in a promissory estoppel case would not have this effect. One's damages would still be limited to the reliance measure.

F. Encouraging Inefficient Breach

A reliance measure provides an incentive to make inefficient breaches of contract.[131] A breach of contract is efficient if it leaves neither party worse off. Expectation damages are efficient because they leave the victim of the breach in just as good a position as if the contract had been performed. Expectation damages provide a party who is contemplating whether to breach an incentive not to, unless he will gain enough by the breach to permit him to compensate the other party for his losses and still have a net profit for himself. Thus, there is an incentive to breach only when neither party will be made worse off.

Reliance damages are not designed to, and usually do not, provide these incentives. Since reliance damages are typically less than expectation damages, parties ordinarily receive too little incentive not to breach. Consequently, parties are encouraged to breach even when their gains will not offset the other party's losses. One might

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128 E. FARNSWORTH, *supra* note 1, § 4.14, at 253.

129 *Id.* § 12.8, at 842-44.

130 *Id.* § 4.15.

131 *See* Robert L. Birmingham, *Breach of Contract, Damages Measures and Economic Efficiency*, 24 RUTGERS L. REV. 273, 285 (1970); Charles J. Goetz & Robert E. Scott, *Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach*, 77 COLUM. L. REV. 554, 556 (1977).

think that because the promisee's reliance occasionally exceeds his expectation, reliance damages might occasionally overdeter intentional breaches. Such overdeterrence would not be desirable because overdeterrence is as inefficient as underdeterrence.[132] But the thought is incorrect in any event. The expectation measure sets a limit on the reliance measure, at least under most circumstances.[133]

G. Encouraging Waste

The reliance measure would also encourage waste under some circumstances if the law made clear that promisees were limited to reliance damages in estoppel cases. Since the promisee would know that he would be entitled only to reliance damages if the promise were not performed, he would be encouraged to run up the reliance damages as high as he justifiably could. This would motivate the promisor to perform in order to avoid having to pay the heightened "reliance" damages. Such conduct would cause waste whether or not the ploy was successful. If the ploy were successful, the promisee would have incurred unnecessary expenses. And if the ploy were unsuccessful, the promisor would pay greater damages than he otherwise would have, to no net benefit to the promisee.[134] Although the contract foreseeability rule sets a limit on how much a promisee could thus add to a promisor's potential liability,[135] this limit is unavoidably flexible. A promisor can never be certain in advance how much, if any, protection the rule will give.

H. Failing to Provide a Secure Basis for Contracting

Finally, the expectation measure is superior to the reliance measure because it provides a more secure basis for promising. It is more secure for the promisee because it provides him with the money equivalent of what he was promised. It is more secure for the promisor because, for the most part, it keeps his risks of liability dependent on events over which he has control. In contrast, the reliance measure makes the promisor's liability dependent on the extent of the promisee's reliance, over which the promisor generally has no control. This is a drawback in any case, but it is intolerable for promisors with thousands or millions of similar contracts out-

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132 Richard Craswell, *Contract Remedies, Renegotiation and the Theory of Efficient Breach*, 61 S. CAL. L. REV. 629, 662-63 (1988).

133 *See, e.g.*, L. Albert & Son v. Armstrong Rubber Co., 178 F.2d 182 (2d Cir. 1949).

134 This point has been made in the law and economics literature often enough to be included in current summaries. *See* A. MITCHELL POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS 34-37 (2d ed. 1989).

135 *See infra* notes 146-51 and accompanying text.

standing at any time. This is the situation of the so-called "standard form contractor," which is extremely common in modern society.

III. Reliance Elements in the Expectation Measure

A. The Entry of Reliance into the Expectation Measure

The promisee's reliance can be the measure of damages in itself, as we have seen.[136] Reliance can also enter into the expectation measure. One formula for stating expectations is the sum of costs of performance incurred by the promisee up to the time of breach and his expected profit on the whole contract. This is the expectation measure commonly used for situations in which the promisor is the owner of the land upon which a building is to be built. The contractor's costs are incurred in reliance on the landowner's promise to pay him when the work is complete. Therefore, the expectation measure is equal to the promisee's reliance plus his expected profit.

The promisee's reliance can also enter into the expectation measure through consequential damages. The purchaser of a new automobile, for example, drives it in reliance on the manufacturer's implied warranty of merchantability. If the owner of the vehicle or the vehicle itself is harmed as a result of a breach of this warranty, the owner is entitled to damages based upon his reliance on the warranty of merchantability. Although there are other ways by which reliance enters into the expectation measure, these two sufficiently illustrate the possibilities.

The fact that reliance is only one of the components of the expectation measure provides some insight into why the reliance measure of damages is deficient. It only compensates for one of the many different ways in which a promisee may have been harmed; the expectation measure, in principle at least, includes all of them. In the two illustrations just given, for example, the reliance element alone is insufficient in one (the building contractor), whereas it is sufficient in the other (the unsafe automobile). The difference, of course, is that there are other important elements of harm in the first case (the contractor's expected profit), but not in the second. Since the automobile owner did not purchase the automobile expecting to make a profit (as he would have if he were a retailer expecting to resell it), his compensation for his out-of-pocket losses was enough to make him whole.

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136 *See supra* notes 18-43 and accompanying text.

B. "Over-Relying"

A line of articles stretching from 1980 to the present, written by members of the law and economics movement,[137] makes the following criticism of the expectation measure: although the expectation measure optimizes the promisor's incentive to perform, it is inefficient in giving the promisee no incentive to restrain his reliance. Promisees, as a result, may "over-rely" because they underestimate the risk that the promisor may not perform, and society as a whole will incur costs that might have been avoided. Some of these commentators have therefore proposed limiting the reliance portion of expectation damages to the "socially optimal" amount of reliance, with the courts deciding, after the fact, how much this would have been.[138] The economic analyses used to reach these conclusions rest on the assumption that the promisee chooses his level of reliance with perfect knowledge of the probability that the promisor will not perform.[139]

The last article in this series that appeared before I finished this Article was one by Richard Craswell.[140] Although he agrees with the criticisms of the expectation measure leveled in previous articles, Craswell rejects the assumption of the promisee's perfect knowledge and the proposal that the reliance portion of expectation damages be limited to what a court decided would have been the socially optimal amount. Instead, Craswell proposes that the promisee's recovery under the expectation measure be limited to the level of reliance that the promisor's statements to him indicated would be socially optimal. Craswell asserts that his proposal is superior for the following reasons: (1) courts are ill-equipped to decide the socially optimal level of reliance;[141] (2) it is fairer to hold the promisee responsible only to the extent that the promisor gave him the information he needed to judge the likelihood of the promisor's performance;[142] and (3) limiting the promisee's recovery in this manner checks the promisor's tendency to overstate the likelihood of his performance, because every increase in the stated likelihood would also increase the damages for which he might be

137 *See, e.g.*, Steven Shavell, *Damage Measures for Breach of Contract*, 11 BELL J. ECON. 466 (1980). *See generally* Richard Craswell, *Performance, Reliance, and One-sided Information*, 18 J. LEGAL STUD. 365, 365-66 (1989) (referring to the law and economics literature on the point since 1980).

138 *See* Craswell, *supra* note 137, at 365-66 n.3 (citing examples of such proposals in the literature).

139 *See id.* at 366 n.4.

140 *Id.*

141 *Id.* at 366, 385-88.

142 *Id.*

liable.[143] Thus, Craswell concludes that his proposed limitation would optimize both the promisor's incentive to perform and the promisee's incentive to rely on the promise.[144]

Craswell's rejection of the unrealistic assumption of the promisee's perfect knowledge is commendable. His proposal that the promisee be bound only to the extent of what the promisor told him is a considerable improvement over the proposal found in prior articles that promisees be held to a standard of perfect information. Nevertheless, neither the criticisms of the expectation measure (in which all the articles, including Craswell's, seem to concur) nor Craswell's improved proposal for remedying the measure's claimed deficiencies is sound. They all rest on the same fallacious assumption of law, and they all violate the same principles of economics and contract.[145]

C. Ignoring the Contract Foreseeability Rule

The law and economics scholars incorrectly assume that a promisee can ignore with impunity the possibility of a promisor's nonperformance. This assumption ignores the contract foreseeability rule, which denies compensation for any losses that would have been avoided by reasonable foresight.[146] For example, a manufacturer that fails to guard against late deliveries of parts or supplies by not keeping a reasonable inventory will be denied compensation for the resulting stoppage of its production line.[147] Likewise, one who sends a financial order to a foreigu bank cannot recover for his reliance upon the bank's promise to follow the order accurately and promptly, to the extent that the sender's reliance exceeds his reasonable expectation of the value of the order being thus followed.[148] Or, if one expends $200,000 in reliance on a promise to grant a fast-food franchise valued at $100,000, the promisor's liability presumably would be limited to $100,000 in the event he breached.[149]

Proper analysis of over-reliance would ask whether the foreseeability rule's incentive not to over-rely is enough, too much, or about right. There is no way of answering this question in the abstract. The answer will vary depending on what value we attach to

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143 *Id.* at 367-68.

144 *Id.* at 398.

145 *See also* Jim Leitzel, *Reliance and Contract Breach*, 52 LAW & CONTEMP. PROBS. 87, 90-91 (1989), which deals with the same subject as does this section, although it makes different assumptions and reaches somewhat different conclusions.

146 E. FARNSWORTH, *supra* note 1, § 12.14.

147 *E.g.*, Hadley v. Baxendale, 9 Ex. 341, 156 Eng. Rep. 145 (1854).

148 *E.g.*, Evra Corp. v. Swiss Bank Corp., 673 F.2d 951 (7th Cir.) (Posner, J.), *cert. denied*, 459 U.S. 1017 (1982).

149 A. CORBIN, *supra* note 28, § 1018.

promisees taking precautions against promises not being performed—and also on what value we attach to promisees *not* having to take such precautions, because they can rest assured that either promises will be performed or that the law will provide adequate compensation if they are not. The law and economics commentators have described why we should place some value on promisees taking precautions. Promisees will incur fewer losses from nonperformance if they take such precautions than if they do not. But these commentators fail to realize that a value ought also to be placed on promisees not having to take the precautions.[150]

The reason a value should also be placed on promisees not having to take precautions against nonperformance is that taking precautions is costly. Costs are associated with keeping inventories of parts or supplies, or taking steps to assure prompt and accurate transmission of messages (such as sending duplicate messages by other means at the same time). The contract foreseeability rule balances the competing values of taking and not taking precautions by the "reasonable person" standard. "Reasonableness" is interpreted by reference to the relevant trade or business as well as to any special warnings either party gave the other at or before the time the contract was made. If he breaches, a contracting party is held liable only to the extent that he could reasonably have foreseen the other party's reliance.[151] Of course, the foreseeability rule as it has evolved may not be ideal in every respect. In particular, it may not be efficient. My point is not to try to decide these issues but only to demonstrate that the law and economics criticisms of the expectation measure were aimed at the wrong target. These scholars should have aimed their criticisms at the foreseeability rule—and presumably would have had they been aware of it.

D. Violating Fundamental Principles

The law and economics scholars also inadvertently violate some fundamental principles of contract law and, ironically, of their own discipline. They would have the law determine, to the extent possible, the efficient degree of reliance. When the law is incapable, the determination would be left to the jury or judge. But this is incon-

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150 The formula symbols that the law and economics commentators use can be interpreted to take the cost of precautions against the other party's nonperformance into account, because they all use some symbol for the value of that party's performance. *See, e.g.*, Craswell, *supra* note 137, at 368. The value of the performance rises if the cost of the precautions against nonperformance drops, and vice versa. Nevertheless, nothing in the way in which the symbols are used or in the textual context indicates the cost of precautions was taken into account. Nothing in the text refers to it expressly or even by reasonable implication.

151 E. FARNSWORTH, *supra* note 1, § 12.14, at 877.

sistent with one of the most fundamental principles of all contract law: freedom of contract. This principle provides that the parties to a contract—not the law, a jury, a judge, or any other public body—make such determinations. The parties make these determinations in their contract, either by express contractual provision or by implied incorporation of trade practice. If a particular degree of reliability is common in the trade, it will be implied in the contract unless refuted by explicit language.[152] The foreseeability rule asks what degree of reliance the breaching party could reasonably have foreseen when the contract was made. The law and economics commentators enforce whatever degree of reliance the law determines would have been optimal.

One might think that the law and economics proposals could be made consistent with freedom of contract by interpreting them as default rules, to be applied only when the parties had not agreed on the amount of reliance to which they were entitled under the contract. Portions of Craswell's article indicate that this is indeed how he intends his proposals to be interpreted. However, those portions are misleading because these proposals still regard the relevant communications between the parties as solely those concerning the probability of performance, and not those concerning the amount of reliance.[153] Under Craswell's proposals, it is still the law or a public official that determines the optimal amount of reliance given the probability of performance. None of the other commentators goes even this far; they would not even give effect to the actual communication between the parties for the purpose of estimating the probability of performance. Rather, they would assume perfect information and have the law, a judge, or jury determine the socially optimal degree of reliance accordingly.[154]

My colleague, George Lefcoe, whose comments to me first suggested this line of argument, also pointed out the bizarre results that would logically follow if the law or a public official, instead of the parties, were to determine the optimal level of reliance. One of the practices to which the efficiency of Japanese industry is attributed is "zero inventory." Manufacturers maintain as little inventory as possible, none in some cases, in order to reduce production costs. The "zero inventory" practice necessitates that supplies that would

152 E. FARNSWORTH, *supra* note 1, § 7.13.

153 *See* Craswell, *supra* note 137, at 386 ("If the promisor has recommended a specific level of reliance to the promisee, no further inquiry is needed to identify the level that appeared optimal in light of the promisor's representations."); *id.* at 396-97 ("[I]n many settings sellers will not be able to express the probability of performance in precise, numerical terms, and will instead have to rely on such phrases as 'virtually certain,' 'about 50-50,' or 'it depends on the weather.' ").

154 *See id.* at 366, 385-88.

otherwise be inventoried be delivered exactly on time. Delivered too soon, they have to be inventoried and so defeat the purpose of the practice. Delivered too late, the production process is brought to a halt.

Some American manufacturers have instituted "zero inventory" practices. Such a manufacturer presumably would notify its suppliers of the practice. Under the foreseeability rule, that notification would be sufficient to hold the supplier liable for the much higher damages that a late delivery would cause, unless something was said to contradict this expectation in the contract. But under the law as the law and economics commentators envisage it, the judge would decide for herself whether the manufacturer's greatly heightened reliance on the supplier's promptness was optimal or not, and award damages accordingly. The judges of state and federal courts would he the ultimate arbiters of the extent to which "zero inventory" was to he adopted by American industry. Precedents would accumulate as their decisions were reported, and eventually there would be "low inventory" and "high inventory" states. The extent to which a manufacturer got legal protection for its "zero inventory" practices would thus depend on where its plants were located.

This result would also violate fundamental principles of economics. The competitive market, not laws or government officials, should answer questions regarding optimum reliance levels or precautions against nonperformance. Businesses that answer such questions more effectively will make more profits, prosper, and eventually come to occupy a larger share of the market. The result urged by law and economics scholars would also violate a fundamental principle of allocative efficiency. Efficiency theory gathers its great power from the principle that each person decides for himself what will increase or decrease his utility. The theory then shows how all individual utilities can be maximized, *each in its own terms*, under the existent constraints, without anyone having to accept what someone else thinks is good for him or for society as a whole. So if the law, judges, or other public officials were to decide how much we could rely on our contracts heing performed, the result would he less efficient than allowing each of us to reach our own decisions.

E. Interpreting Theoretical Works of Law and Economics

It has been forcefully argued to me that the foregoing criticisms are unfair and unjustified. Works of theory, I was told, are not to be interpreted as having any relevance to anything outside their own ambit unless they say so expressly. Perhaps my criticisms were therefore wrong in interpreting the articles concerned as uninten-

tionally ignoring the contract foreseeability rule, because they can more reasonably be interpreted as intentionally ignoring it. According to this line of argnment, they should be interpreted as theoretical exercises in the effects the expectation measure would have on promisees' reliance if the expectation measure were the only rule of contract law in existence. Since none of the articles expressly says that the law of contract does not contain a contract foreseeability rule, none of them can fairly be criticized for ignoring it.

I disagree.

One could hardly expect a writer who was unintentionally ignoring something to say he was ignoring it. That would be about as likely as a person forgetting to take his umbrella saying, "By the way, I am not taking my umbrella." Additionally, the foreseeability rule is so well known as to make it incredible that the failure to mention it was an intentional experiment rather than a simple mistake. The rule dates from 1854, when it was originated in the famous English case of *Hadley v. Baxendale*.[155] It has been in common use ever since, as can be seen by a reference to any reasonably complete compilation of contract law published since the late nineteenth century. Any thought experiment of what the law of contract would be like without it would be about as unlikely as a thought experiment of what automobiles would be like with only three wheels.

My criticisms were also said to be wrong in assuming that the articles at which they were directed were urging changes in the law, when in fact they were not. No matter how sharply articles criticize existing law or how strongly they urge the superiority of rules that differ from it, I was told, they should not be interpreted as calling for changes in the law unless they expressly call for them. Again, in the absence of express language, they should be interpreted as exercises in pure theory. I fail to see the benefit in such a restricted interpretation, however, and it would surely be contrary to most writers' intent. If those of us who express normative judgments about the law do not hope that someone will act on them, why do we express them? At the very least, it would seem incumbent on someone who made normative judgments but did not want anyone to act on them to explicitly express this desire.

Certainly many law and economics commentators have shown by their words or actions that they hope their normative judgments will be acted upon. Lewis A. Kornhauser's *An Introduction to the Economic Analysis of Contract Remedies*,[156] for example, makes the following observation in its initial pages:

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155 9 Ex. 341, 156 Eng. Rep. 145 (1854).

156 57 U. COLO. L. REV. 683 (1986).

> "While courts have not yet sought guidance from economic analysis, an understanding of its principles is likely to prove useful to the practitioner for several reasons. First, economic analysts have offered substantial arguments for revising or rationalizing specific doctrines. Those seeking to reform the law governing liquidated damages or specific performance or to rationalize the law of mitigation would do well to consult the economically informed literature."[157]

Kornhauser is not just saying that it is his opinion that those seeking to reform the laws he mentions would do well to consult the economically informed literature. I think it is also fair to read him as assuming that the analysts to whom he refers had similar hopes for their analyses. The two prominent law and economics commentators on the Seventh Circuit Court of Appeals, Richard A. Posner and Frank H. Easterbrook, provide another kind of example. They have not hesitated to use their own or others' law and economics analyses in their own judicial decisions.[158]

Finally, one does not even need to interpret the articles I have criticized as calling for changes in the law in order to make my criticisms valid. It is enough just to hold them to ordinary standards of relevance. They address the subject of law and economics. Presumably the "law" is the law of the United States. What is the relevance of a law and economics article not thought to deal with the law with which the reader is familiar? The only reasonable interpretation of *any* article in law and economics, in the absence of some clear warning to the contrary, is that it is dealing with the law that actually exists in the country of its intended readers.

F. Mea Culpa

I contributed to the errors in the law and economics commentary discussed in the preceding criticism. After reading an earlier draft of Richard Craswell's article that is among those I have just criticized, and participating in a workshop at which it was presented, I failed to discern these errors initially. They dawned on me almost a year later in preparing this article. This experience has caused me to reflect on why I had been so careless. That the contract foreseeability rule both deters and limits liability for a promisee's over-reliance is such an obvious fact to anyone familiar with contract law, that it seems incredible that the ignoring of it in Craswell's paper was not immediately evident to me. It seems just as incredible, of

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157 *Id.* at 684-85 (footnotes omitted).

158 *See, e.g.*, Flamm v. Eberstadt, 814 F.2d 1169 (7th Cir. 1987) (Easterbrook, J.); Evra Corp. v. Swiss Bank Corp., 673 F.2d 951 (7th Cir.) (Posner, J.), *cert. denied*, 459 U.S. 1017 (1982).

course, that Craswell and all the others beginning with Shavell back in 1980 also overlooked the rule.

Presumably the readers of these articles also overlooked the omission of the foreseeability rule. If not, presumably some of them would have communicated with the authors privately or published something pointing out their oversight. An article by Jeffrey M. Perloff, in fact, published only a year after Shavell's article, argues that the foreseeability rule solves the efficiency problems about which Shavell and the others in the series are concerned. In so doing, he cites Shavell's article.[159] Perloff's article, moreover, was published in *The Journal of Legal Studies*, which specializes in law and economics. Perhaps the article was never noticed by the authors who followed Shavell because, despite citing Shavell, Perloff's criticism was not aimed directly at him. Perloff characterized his target as the line of articles concerned with the "appropriate remedy in the event of breach of contract."[160] These possible remedy rules, as he conceived of them, were rules *in addition* to the expectation measure.[161] Shavell and the authors who followed him, on the other hand, conceived of the expectation measure as operating without qualification, as we have seen. In the last analysis, however, I do not think there is any explanation except that we bungled it. The only thing to be done now is to expose the mistake, which I hope I have, and get on to matters upon which we can spend our time more usefully.

CONCLUSION

The attempts to replace the expectation measure with the reliance measure of damages when the breached contract was based on promissory estoppel all suffer from the same fallacy. They equate the measure of compensation with the grounds of enforcement, an equation that has no basis in logic or policy. Furthermore, such an equation insures that the compensation will be inadequate in any case except one in which the promisee's reliance coincidentally happens to equal his expectation. The proponents have nothing more to support their attempts than their reluctance to see "pure" contract "polluted" by the doctrine that originated in tort. They are the last holdouts in a battle that the legal conservatives were waging against promissory estoppel even before the *Restatement (First) of Contracts* was published in 1932.

The efficiency criticisms of the expectation measure also suffer

159 Jeffrey M. Perloff, *Breach of Contract and the Foreseeability Doctrine of* Hadley v. Baxendale, 10 J. LEGAL STUD. 39, n.1 (1981).

160 *Id.* at 39.

161 *See id.* at 43-44.

from fallacies although these are even more elementary. They ignore the foreseeability rule and all other contract doctrines that affect the parties' incentives and influence the amounts of damages they must pay or can receive. They violate the principles of freedom of contract and of efficiency. These principles dictate that the parties be allowed to determine the extent to which their reliance on the other's performance shall be compensated if the performance is not forthcoming.