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Recovering Pre-contractual Expenditures as an Element of Reliance Damages

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I. INTRODUCTION

SHOULD a person who has made expenditures before entering into a contract be able to recover those expenditures as an element of damages if that contract is breached? This question does not arise in those breach of contract actions where either expectation or restitution damages are awarded. It can arise, however, in cases where the court elects to award reliance damages.

The conventional wisdom among commentators is that it is inappropriate to allow recovery of pre-contractual expenditures as part of a reliance interest-based award,[1] and that the courts, at least in the United States, have generally accepted this proposition and denied such recovery.[2] Closer inquiry reveals, however, that a persuasive argument can be made for allowing recovery of pre-contractual expenditures under the reliance interest rubric, so long as it was in the reasonable contemplation of the contracting parties that those expenditures would be wasted in the event of breach. Moreover, there is some support to be found in the United States case law—and quite substantial support in the British Commonwealth case law—for doing so. This article will present and evaluate that argument as well as review and reassess the relevant case law in light of it.[3]

Part II of this article will briefly summarize the basic principles governing the award of damages for breach of contract. Part III will set forth the argument for allowing recovery of pre-contractual expenditures as an element of reliance damages awards. Part IV will review the British

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1. *See, e.g.*, 5 ARTHUR CORBIN, CORBIN ON CONTRACTS § 1034 (1950) ("It is to be observed also that expenses incurred in inducing the making of the contract are not [recoverable] expenses in preparation and part performance. . . . They are caused neither by the breach of the contract nor by its making."); E. ALLAN FARNSWORTH, CONTRACTS 928 (2d ed. 1990) ("[Reliance damages] will not help the injured party who has done nothing in reliance on the contract."); Mark Pettit, *Private Advantage and Public Power: Reexamining the Expectation and Reliance Interests in Contract Damages*, 38 HAST. L.J. 417, 425 (1987) ("Reliance damages would cover only expenditures incurred after the promise was made."). *See also* J. E. Macy, Annotation, *Right to Recover, in Action for Breach of Contract, Expenditure Incurred in Preparation for Performance*, 17 A.L.R.2D 1300 (1951).

> For expenditures incurred before the actual making of the contract, a defendant is not liable unless he is affirmatively shown to have assumed responsibility for them. The action is based upon the contract and can include only losses sustained as a consequence of it. The rule applies even if the expenditures were incurred directly for the purpose for which the plaintiff made the contract . . . .

Id. at 1314.

2. FARNSWORTH, *supra* note 1, at 928 n.2 ("It has . . . been held [by United States courts] that an injured party cannot recover for costs incurred *before* that party made the contract."); A. I. OGUS, THE LAW OF DAMAGES 349 (1973) ("American authorities have rejected claims for pre-contract expenditure.").

3. This article will not consider the related issue of liability for expenditures or other conduct carried out in anticipation of a later contract that is never entered into. For an extensive discussion of the liability issues raised by failed negotiations, see generally E. Allan Farnsworth, *Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations*, 87 COL. L. REV. 217 (1987).

Commonwealth and United States case law relating to this question. In Part V, I will propose and discuss in detail a "reasonable contemplation" standard for resolving claims for recovery of pre-contractual expenditures and reassess the case law in light of this standard. Part VI will present a brief conclusion.

II. BASIC CONTRACT LAW DAMAGES PRINCIPLES

The usual award sought by a plaintiff in a breach of contract action is expectation damages: the sum needed to put him in the position he would have been in had all parties to the contract fully performed their obligations.[4] When expectation damages are awarded, there is no need to determine whether the plaintiff has made pre-contractual expenditures in anticipation of the contract. The plaintiff is entitled to the value of the defendant's promised performance, less any costs that the plaintiff has avoided (or should have avoided) as a result of the defendant's breach.[5] Neither the magnitude nor the timing of the plaintiff's expenditures are relevant to this calculation except to the extent that they bear upon the avoidability issue.

Under some circumstances, however, courts will base their awards on a restitution measure[6] or a reliance measure[7] of compensation rather than attempt to protect the plaintiff's expectation interest. Awards of restitution damages are intended to force the defendant to disgorge his gains from breach: to return him to the position he occupied at the time the contract was formed.[8] The calculation of restitution damages again does not require an inquiry into the magnitude or timing of the plaintiff's expenditures, since the focus is exclusively upon the position of the defendant at two different points in time, not upon the situation of the plaintiff.

The award of reliance damages, however, necessitates a different inquiry. A reliance damages recovery is intended to protect the plaintiff's reliance interest: to restore him to the position he occupied at the moment of contract formation before he commenced to rely upon the defendant's promises.[9] Calculation of a reliance damages award requires determination of the size of the plaintiff's reliance losses, be they expenditures or value lost as a result of forgone alternative opportunities. The amount of the plaintiff's expenditures is of course relevant to this inquiry, as is the question of whether those expenditures were in fact made in reliance upon the defendant's promises. The timing of those expenditures—whether they were made before or after the formation of the contract—would appear to be directly relevant to the question of whether they were made in reliance upon the promise and therefore recoverable.

4. FARNSWORTH, *supra* note 1, at 40.
5. *Id.* at 896.
6. *Id.* at 843.
7. *Id.* at 842.
8. *Id.* at 843.
9. *Id.* at 842.

Similarly, the value of any opportunities forgone in reliance upon the contract, and the timing of those choices, would appear to be relevant to the reliance inquiry.

The goal in awarding reliance damages is to restore the plaintiff to the position he was in at the moment of contract formation.[10] Two corollaries derive from this basic proposition. First, the plaintiff should be entitled to recover not only his expenditures made in reliance upon the defendant's promise, but also the value of any opportunities that he has forgone in reliance upon the contract.[11] Revenues forgone are economically equivalent to expenditures, and the complete restoration of a plaintiff to his pre-contractual position requires not only the reimbursement of his expenditures but also compensation for his forgone opportunities.[12]

Secondly, it would appear to be inappropriate to allow compensation for any pre-contractual expenditures, or for the value of any opportunities pre-contractually forgone, as part of a reliance damages award.[13] Any expenditures or other changes of position made before a contract is formed may well take place in anticipation of that contract, but would have occurred even if the anticipated contract never results.[14] Rather than characterize those pre-contractual expenditures or other acts as having been made in reliance upon the later contract, it is more reasonable to regard them as having been made only on the basis of the plaintiff's hopeful expectations.[15] It consequently seems unfair, under a reliance-based theory of recovery, to burden the defendant with the responsibility for the plaintiff's pre-contractual conduct.

III. THE ARGUMENT FOR ALLOWING RECOVERY OF PRE-CONTRACTUAL EXPENDITURES AS AN ELEMENT OF RELIANCE DAMAGES

The position generally taken by commentators that recovery of pre-contractual expenditures should not be allowed as an element of reliance damages[16] thus seems on its face to have a very solid foundation. Given

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10. *Id.*

11. Lon Fuller & William Perdue, *The Reliance Interest in Contract Damages*, 46 YALE L.J. 52, 55, 60 (1936); Michael Kelly, *The Phantom Reliance Interest in Contract Damages*, 1992 WIS. L. REV. 1755, 1761 ("The reliance interest must include some measure of the opportunities the plaintiff gave up in order to enter into the contract with the defendant.").

12. Kelly, *supra* note 11, at 1761.

13. Pettit, *supra* note 1, at 425 n.31 ("Reliance expenditures made before the promise . . . theoretically would not be recoverable since they would have been made even if the . . . [promisor] had never made the promise . . . .").

14. *Id.*

15. Pre-contractual expenditures

> are not made in reliance upon the *contract* and can not be said to be a loss caused by breach of the contract, as the sums were expended whether or not a contract ultimately came into existence. It is not logical that such expenses should change their nature and become recoverable damages (in the event of breach) at the time the contract is signed.

David P. Grinlinton, *Damages for Wasted Expenditures in Contracts for the Sale of Land*, 5 AUCKLAND U. L. REV. 37, 46-47 (1984).

16. *See, e.g.*, Pettit, *supra* note 1, at 425 n.31.

this fact, it is not surprising that the oft-repeated assertion that the case law supports this position[17] has not been subjected to close scrutiny.

The matter is not, however, quite as simple as it first appears. There are situations which raise complications that call into question the simple logic set forth above, and a close review of the case law reveals an uneasy grappling with those problems. I am of the opinion that the better rule of law is that under certain circumstances pre-contractual expenditures should be recoverable as an element of reliance damages, and that the case law—particularly the British Commonwealth case law, but also one line of American cases—provides substantial support for this position. In my view, those expenditures should be recoverable when all of the following elements are satisfied:

1) when it is in the reasonable contemplation of the parties to the contract, at the time of contract formation, that those expenditures will likely be wasted in the event of breach, and
2) when the recovery of those expenditures does not conflict with any of the standard foreseeability, avoidability, certainty, or "losing contact" limitations on recovery, and
3) when such recovery has not been precluded by the agreement of the parties.

Let me develop the argument in support of this position in the following Sections of this Part.

A. The Problem of Inadequate Compensation for Lost Opportunities in Reliance Damages Awards

Restoring a plaintiff to the position he occupied at the time of contract formation requires, in theory, compensating him for the value of opportunities forgone in reliance upon the contract as well as for his expenditures. As a practical matter, however, it is a rare reliance damages award that includes any compensation whatever for lost opportunities.[18] The usual circumstance in which reliance damages are awarded is where the plaintiff cannot establish his lost profits with the requisite degree of certainty required for an expectation interest-based recovery.[19] Denied the opportunity to recover the benefit of his bargain, he will then generally elect to attempt to recover reliance damages sufficient to restore him to his pre-contractual position. When attempting to establish the value of the alternative opportunities forgone in reliance upon the contract, however, he will almost always founder on the same lack-of-certainty difficul-

17. *See, e.g.*, FARNSWORTH, *supra* note 1, at 928 n.2.

18. "[T]he law has not generally recognized yet another kind of reliance—reliance that consists in forgoing opportunities. . . . [C]ourts have not been receptive to claims based on this kind of reliance." FARNSWORTH, *supra* note 1, at 267.

19. *Id.* at 928. Somewhat surprisingly, courts rarely award reliance damages in those breach of contract actions decided under the authority of § 90 of the Restatement (Second) of Contracts. RESTATEMENT (SECOND) OF CONTRACTS § 90 (1981); *see infra* text accompanying note 23.

ties that rendered him ineligible for an expectation damages award.[20] The profits that would have been earned through a particular alternative contractual arrangement will, as a general matter, be at least as speculative as those claimed (and rejected) under the contract that was breached.[21] There exist, moreover, the added uncertainties concerning the identity of the party with whom this alternative contract would have been made, if such an alternative contract would have been entered into at all, and what its terms would have been.

The plaintiff who receives a reliance damages award will thus usually recover only his reliance expenditures.[22] To the extent that profits would have been made on the contract if it had not been breached, or on an alternative contract if the plaintiff had not relied upon the defendant's promises, such a reliance damages award undercompensates the plaintiff.

B. Allowing Recovery of Pre-Contractual Expenditures as a Proxy for the Value of Forgone Opportunities

Courts doubtless recognize that when reliance damages are awarded subject to the usual certainty limitations, the result is systematic undercompensation of plaintiffs (albeit variable in magnitude) for their lost opportunities. They are, however, restrained by these limitations from directly recognizing and compensating for such intangible losses. One way in which judges have responded to this problem is by avoiding it and awarding expectation damages even under circumstances where it may be more appropriate to protect the plaintiff's reliance interest. This tendency is documented by a recent article that reveals that, when courts enforce relied-upon promises under the authority of Section 90 of the *Restatement (Second) of Contracts*,[23] they almost invariably do so by awarding expectation damages rather than reliance interest-based awards.[24] This is somewhat surprising, given that the basis for the enforcement of promises under Section 90 is reliance rather than mutual agreement,[25] and given that Section 90 includes an express invitation to judges to limit the remedy granted to a reliance interest-based recovery

20. Farnsworth, *supra* note 1, at 921-28. "[R]eliance becomes even more difficult to value than expectation in precisely those cases in which courts seek an alternative to the difficult expectation measure." Pettit, *supra* note 1, at 457. The fact that reliance damage awards, in practice, generally compensate only for expenditures and not for the value of lost opportunities has recently come under scrutiny and criticism. *See, e.g.*, Kelly, *supra* note 11.

21. Pettit, *supra* note 1, at 457.

22. Farnsworth, *supra* note 1, at 843. "In practice, courts employing the reliance measure generally restrict themselves to out-of-pocket losses (disregarding the concept of lost opportunity) . . . ." Pettit, *supra* note 1, at 454.

23. Restatement (Second) of Contracts § 90.

24. "[T]he remedy courts routinely grant under Section 90 is specific performance or (if feasible) expectation damages. Cases granting less than expectancy relief are relatively rare . . . ." Edward Yorio & Steve Thel, *The Promissory Basis of Section 90*, 101 Yale L.J. 111, 112-13 (1991).

25. Restatement (Second) of Contracts § 90.

where justice so requires.[26] One explanation that has been advanced for this failure of courts to make greater use of reliance interest-based remedies in Section 90 litigation is continuing judicial adherence to the classic Willistonian position that promises are to be enforced either fully or not at all.[27] This is the primary explanation endorsed by Edward Yorio and Steve Thel in their important article on the subject.[28] Other explanations, however, are also possible. It may well be that the courts have moved beyond the views held by Williston and do now accept the principle embraced by Section 90 that it may be appropriate in some circumstances to limit the remedy available for the breach of promises that are enforceable only because of promisee reliance to reliance damages. The judges likely also understand, however, that reliance damages as awarded in practice fail fully to protect plaintiffs' reliance interests because of their failure to reflect the value of forgone opportunities. This recognition of the practical shortcomings of reliance damages awards, rather than continuing adherence to Willistonian conceptions of the source and nature of contractual obligations, may be the primary factor that underlies judicial reluctance to award reliance damages wherever expectation damages can be established with reasonable certainty. It may also be the primary factor that limits the use of the reliance damages remedy primarily to those cases that raise serious questions as to the certainty of the losses alleged.[29]

In my view, given the asymmetric, pro-defendant bias in the operation of the certainty limitations as applied to reliance damages awards, courts should, in the interest of achieving substantial justice, be receptive to new legal doctrines that would allow them partially or wholly to correct for the undercompensation problem where it cannot be otherwise avoided. In particular, they should try to give force in their reliance damages awards to any tangible evidence submitted by the plaintiff as to funds expended and wasted in connection with the breached contract, even if those expenditures took place before the moment of contract formation and therefore do not fit precisely into the traditional "reliance" categories.

I concede that recovery of pre-contractual expenditures (or of the value of pre-contractually forgone opportunities) would have no proper place in a theoretically sound reliance damages award that compensated the plaintiff for his post-contractual forgone opportunities as well as for his post-contractual reliance expenditures. Such a comprehensive award

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26. *Id.*

27. "Either the promise is binding or it is not. If the promise is binding it has to be enforced as it is made. . . . [T]he question of damages for breach of a promise is ordinarily such a sum as will put the promisee in as good a position as he would have been in if the promise had been kept, not as good a position as he would have been in if the promise had not been made . . . ." *Proceedings at Fourth Annual Meeting*, 4 A.L.I. PROC. 103, 111-12 (1926) (statements of Samuel Williston).

28. Yorio & Thel, *supra* note 24, at 114-15, 132-36.

29. *See generally* Fuller & Perdue, *supra* note 11, at 60-62; JOHN MURRAY, MURRAY ON CONTRACTS 281-84 (3d ed. 1990).

would fully restore the plaintiff to his pre-contractual position. We live, however, in an imperfect world that sometimes requires second-best solutions, and allowing compensation for at least certain kinds of pre-contractual expenditures will in practice bring us closer to the goal of making disappointed promisees whole, since such compensation will augment reliance damages awards that otherwise now systematically undercompensate promisees because they fail to allow recovery for the value of opportunities forgone in reliance upon the contracts.[30]

C. Appropriate Limits on Allowing Recovery of Pre-contractual Expenditures as a Proxy for the Value of Forgone Opportunities

Even if one recognizes that allowing recovery of pre-contractual expenditures could enable courts to make awards that generally come closer to providing full protection of promisees' reliance interests than do current reliance damages awards that effectively ignore the value of post-contractually forgone opportunities, one should be hesitant to embrace a principle that would allow expanded recovery unless its application can be properly limited to appropriate circumstances. This new principle of recovery appears at first glance to be relatively expansive and unconstrained. Once one deems the plaintiff's pre-contractual expenditures relevant for damages calculation purposes, there is no immediately obvious limit to the breadth of the defendant's exposure. How "far back" before the time of contracting, and how "far away" from his contractual obligations, will the plaintiff be allowed to go in ascribing responsibility for his expenses to the defendant on the basis of his "reliance" on the contract? One must recognize the concern that, once one allows reliance damages awards to cover expenditures that occurred before the event purportedly relied upon, it may prove difficult properly to limit the scope of pre-contractual expenditures that can qualify as compensable reliance. I would like to argue, however, that there are in fact some reasonable and feasible limitations that can be placed upon this expanded conception of reliance damages that will allow for recovery of pre-contractual expenditures only where doing so will mitigate the undercompensation problem, without going to the other extreme of overcompensating plaintiffs and placing unfair burdens upon defendants.

I would like to begin by reviewing the relevant case law to identify what categories of pre-contractual expenses have been allowed as elements of reliance damages awards, and under what circumstances. I will

30. In accord is Pettit, *supra* note 1, at 425 n.31.

> As a practical matter, if a court is unwilling or unable to compensate the plaintiff for opportunities lost as a result of contracting with the defendant, it may make sense at least to award compensation for precontractual expenditures on the grounds that had the defendant not made her promise the plaintiff would have entered into an alternative contract that would have covered his precontractual expenses.

Id.

propose a principle for use as a criterion for making this determination—a "Reasonable Contemplation" standard—and will then discuss its features and apply it to the facts of the cases to determine how its use would have affected the results reached.

IV. THE CASE LAW

The case law concerning the recovery of pre-contractual expenditures as an element of reliance damages has developed along two independent lines that are surprisingly divergent. The British Commonwealth courts have over the past few decades been quite receptive to claims for recovery of pre-contractual expenditures. The American courts, in contrast, have been relatively hostile to such claims, although there are a few cases allowing recovery. Let me first trace the development of the Commonwealth case law, and then turn to the United States opinions.

A. THE COMMONWEALTH CASES

Before 1971 courts in the Commonwealth countries had long embraced the principle that pre-contractual expenditures could not be recovered as an element of a reliance damages award,[31] except under a very narrow exception. This exception originated in the 1850 English case of *Hanslip v. Padwick*,[32] which allowed the plaintiff to recover his pre-contractual expenses of investigating title in an action for a breach of a contract to convey land.[33] This limited exception was extended slightly almost a century later in the English case of *Wallington v. Townsend*,[34] which also allowed recovery of the pre-contractual expenditures incurred for the legal costs of approving and executing a subsequently breached contract to convey land.[35]

In 1971, this narrow exception was substantially enlarged, albeit still within the land conveyance context, by the ruling in the English case of *Lloyd v. Stanbury*.[36] There the plaintiff and defendant had reached an informal agreement under which the defendant would convey a parcel of land, and as part of that agreement the plaintiff had agreed to provide a

31. *See, e.g.*, Hodges v. Earl of Litchfield, 131 Eng. Rep. 1207, 1209 (1835) ("The expenses preliminary to the contract ought not to be allowed. The party enters into them for his own benefit at a time when it is uncertain whether there will be any contract or not."). *See also* Perestrello & Companhia Limitada v. United Paint Co. Ltd., 113 Sol. J. 324, 329 (1969) (Eng.) (denying recovery of pre-contractual expenditures incurred after the execution of a non-binding agreement in principle: "[In my judgment] precontract expenditure, though thrown away, is not recoverable.").

32. 5 Ex. 615, 155 Eng. Rep. 269 (1850). David Grinlinton has suggested that this exception may have its historical roots in the fact that the investigation of title in early nineteenth-century England generally took place *after* the contract was made, and such expenses were therefore obviously recoverable. Once title investigation became more generally a pre-contractual practice, the courts chose to maintain continuity and continued to allow recovery of those expenses. Grinlinton, *supra* note 15, at 49.

33. *Hanslip*, 5 Ex. at 615.

34. 1 Ch. 588 (1939).

35. *Id.*

36. 1 W.L.R. 535 (Ch. 1971) (Eng.).

caravan[37] for the use of the defendant that would be placed on the property until the defendant had completed a bungalow on an adjoining parcel retained for that purpose. The plaintiff subsequently had his caravan moved onto the parcel for the defendant's use. This was done five days before the signing of a formal contract of sale that gave the prior agreement legal force and that included a term making the provision of the caravan a contractual duty of the plaintiff. The defendant subsequently breached the contract, and the plaintiff sought to obtain a reliance interest-based recovery that included, among other items of damages, his pre-contractual conveyancing expenses and the costs he had incurred before the signing of the contract to move the caravan to the site. The *Lloyd* court allowed recovery of both the conveyancing and moving expenses, stating:

> In my judgment the damages which [the plaintiff] . . . is entitled to recover include expenditure incurred prior to the contract representing (1) legal costs of approving and executing the contract and (2) costs of performing an act required to be done by the contract notwithstanding that the act is performed in anticipation of the execution of the contract. In addition, the buyer is entitled on general principles to damages for any other loss which ought to be regarded as within the contemplation of the parties.[38]

The final sentence quoted above, though perhaps properly regarded as mere dicta since it was made in a case involving only claims for recovery of conveyancing costs and subsequently required expenditures in the land contract context, obviously suggests the possibility of extending the allowance of pre-contractual expenditures well beyond that context, and beyond those expense categories. That implicit suggestion was soon embraced in the celebrated English Court of Appeal case of *Anglia Television Ltd. v. Reed*.[39]

The plaintiff in *Anglia* had contracted with Robert Reed, a well-known actor, to play the leading role in a television play. Prior to entering into this contract, the plaintiff had made expenditures for a director, a designer, and a stage manager for the play. Reed subsequently repudiated the contract, and the plaintiff, unable to locate a suitable replacement, sued for breach. Choosing not to attempt to recover lost profits because of their speculative character, the plaintiff instead sought a reliance interest-based recovery of its wasted expenditures, including its pre-contractual expenditures.

The *Anglia* court allowed the plaintiff a judgment for the full amount claimed.[40] After noting that a plaintiff was entitled to elect to recover his

37. "Caravan" is a British term for a mobile home.

38. *Lloyd*, 1 W.L.R. at 546. The *Lloyd* court failed to discuss (or even cite) the contra position taken two years earlier in Perestrello & Companhia Limitada v. United Paint Co. Ltd., 113 Sol. J. 324 (1969) (Eng.) (discussed *supra* note 31).

39. 1 Q.B. 60 (C.A. 1972).

40. *Id.* at 64.

wasted expenditures rather than to seek lost profits,[41] the court stated broadly:

> If the plaintiff claims the wasted expenditure, he is not limited to the expenditures incurred *after* the contract was concluded. He can also claim the expenditure incurred *before* the contract, provided that it was such as would reasonably be in the contemplation of the parties as likely to be wasted if the contract was broken. . . . This decision is in accord with the correct principle, namely, that wasted expenditures can be recovered when it is wasted by reason of the defendant's breach of contract. It is true that, if the defendant had never entered into the contract, he would not be liable, and the expenditure would have been incurred by the plaintiff without redress, but, the defendant having made his contract and broken it, it does not lie in his mouth to say he is not liable, when it was because of his breach that the expenditure was wasted.[42]

While the *Anglia* decision has received mixed reviews from commentators,[43] it has been followed or at least cited approvingly by all of the Commonwealth opinions that have referred to it,[44] with one possible exception.[45] For example, in the English case of *C.C.C. Films (London) Ltd. v. Impact Quadrant Films Ltd.*,[46] the court allowed the plaintiff to recover $12,000, a sum that it had previously expended under a prior contract with the defendant to obtain a license to exhibit three motion pictures, as wasted expenditures in an action for breach of a second, subsequent contract to deliver copies of those films to the plaintiff.[47]

Two additional interesting cases applying the *Anglia* standard were decided in New Zealand. In the unreported 1983 opinion of *O'Connell v. Hay*[48] the defendant had repudiated a contract to sell his farm. The plaintiff then sued seeking to recover his wasted expenditures. The

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41. *Id.* at 63-64.

42. *Id.* at 64 (emphasis in original).

43. *See, e.g.*, D. W. McLauchlan, *Damages for Pre-Contract Expenditure*, 11 N.Z.U. L.R. 346, 351-54 (1985) (discussing *Anglia* approvingly and at length); Grinlinton, *supra* note 15, at 48-50 (criticizing *Anglia*); A. I. Keesing, *Pre-Contract Expenses—An Equitable Decision?*, 1983 N.Z. REC. L. REV. 296 (1983) (criticizing *Anglia*); A. I. Ogus, Note, *Damages for Pre-Contract Expenditure*, 35 MODERN L.R. 423 (1973) (criticizing *Anglia*).

44. *See, e.g.*, C.C.C. Films (London) Ltd. v. Impact Quadrant Films Ltd., 1 Q.B. 16 (1985) (Eng.) (*see infra* text accompanying note 46); Fieling v. Newell, 1986 Outer House Cases (Sess. Nov. 28, 1986) (Scot.) (LEXIS, Intlaw library, Scocas file) ("I am not satisfied that this claim should be restricted to expenditure incurred after the contract was concluded. The description given by the pursuer of these items does not suggest to me that they would not be in the reasonable contemplation of the parties as likely to be wasted if the contract was broken.") (citing *Anglia* in support). *See also* Bloom (Kosher) & Sons Ltd. v. London Borough of Tower Hamlets, 35 P.& C.R. 423 (1977) (Eng.) (citing *Anglia* with approval); McLauchlan, *supra* note 43, at 360 (citing O'Connell v. Hay, Dunedin Registry, A.48/82 (Feb. 4, 1983) (N.Z.) (Cook, J.) and following *Anglia*) (*see infra* text accompanying note 48).

45. McLauchlan, *supra* note 43, at 375 (citing Ash v. Victor Enters., Auckland Registry, A.591/70 (Aug. 5, 1974) (N.Z.) (Cooke, J.)). *See infra* text accompanying notes 50-53.

46. 1 Q.B. 16 (1985).

47. *Id.*

48. Dunedin Registry, A.48/82 (Feb. 4, 1983), *cited in* McLauchlan, *supra* note 43, at 360.

O'Connell court held, on the authority of *Anglia*, that pre-contractual expenditures that the defendant could reasonably contemplate would be wasted as a consequence of breach were recoverable.[49]

In the other unreported New Zealand case the court recognized the authority of *Anglia* but distinguished that case as inapplicable to the facts before it.[50] *Ash v. Victor Enterprises*,[51] however, can also be reasonably read as an implicit repudiation of the rationale of the *Anglia* opinion. The plaintiff there had resigned a position to accept a contract of employment with another employer. By resigning that position he forfeited his right eventually to receive over $4000 of superannuation payments from that former employer. Later, in an action for the breach of the second employment contract, the plaintiff sought to recover the value of that forgone superannuation payment. The *Ash* court denied recovery of this sum, distinguishing the *Anglia* precedent as inapplicable.[52]

The *Ash* opinion on its face appears to stand for the proposition that the scope of recoveries allowed under *Anglia* is properly limited to pre-contractual expenditures, and that *Anglia* does not support allowing recovery of the value of pre-contractually forgone opportunities. Whether a meaningful distinction can be drawn, however, between *Anglia*-type pre-contractual expenditures and pre-contractually forgone revenues is debatable.[53] Expenditures and forgone revenues are economically equivalent. In both *Anglia* and *Ash* the promisee chose to make a financial sacrifice in relation to and in anticipation of a future contract, the sacrifice being wasted upon the defendant's breach, and this wastage being in the reasonable contemplation of the parties at the time of contracting as a likely consequence of breach. Consequently, the *Ash* ruling should perhaps not be viewed as merely distinguishing *Anglia*, but read more broadly as an implicit rejection of the core principle of *Anglia*.

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49. *Id.*

> [T]here seems no reason why expenditure incurred prior to the signing of the contract which is of a type which would normally be incurred as part of the process leading to the formalisation of the bargain and, as such, could be contemplated by the other party, should not be recoverable.

Id.

50. Ash v. Victor Enters., Auckland Registry, A.591/70 (Aug. 5, 1974) (Cooke, J.), *cited in* McLauchlan, *supra* note 43, at 357.

51. *Id.*

52. *Id.*

> It seems to me that the plaintiff's claim must fail in that the forgoing in part of his former superannuation right was not caused by the defendant's breach of contract. The *Anglia* case is distinguishable because there was in that case nothing equivalent to the election in this case to abandon one contract for another, and because the present is not a case of pre-contract expenditure for the purpose of carrying out a proposed contract. In truth the plaintiff's loss of superannuation here is due to his judgment in accepting a position with the defendant in the first place, rather than to anything that happened later.

Id. (quoted from *Ash* opinion by McLauchlan, *supra* note 43, at 358).

53. McLauchlan, *supra* note 43, at 358-59; Note, *Contract Law—Damages—Pre-contractual Expenditure*, 1975 N.Z. L.J. 29, 30 ("Whether *Anglia TV v. Reed* is so easily distinguishable is an open question.").

B. The United States Cases

There were early intimations in the United States case law of judicial disfavor of recovery of pre-contractual expenditures. There were, for example, two cases—decided in 1834 and 1850, respectively—that each denied recovery of pre-contractual expenditures as part of an expectation interest-based award.[54] The rulings in those cases, however, were each phrased in relatively broad language that suggested that a plaintiff might not be allowed to recover pre-contractual expenditures even if he sought only to protect his reliance interest.[55] Two other similar late-1800s cases were subsequently decided, one of which again denied recovery of pre-contractual contract procurement expenses sought as part of an expectation interest-based award.[56] The second denied recovery of pre-contractual brokerage expenditures under a liquidated damages clause that directed the defendant to pay all damages "arising from default" of his vendor obligations under a real estate contract.[57]

The first opinion of which I am aware whose holding was a rejection of recovery of pre-contractual expenditures in the reliance damages context was the 1893 New York opinion of *Steers v. Laird*.[58] That case involved a suit by a seller of real estate to recover his pre-contractual brokerage expenditures as damages for the defendant's breach. The *Steers* court rejected the reasoning of an earlier New York case, *Hening v. Punnett*,[59] that had (without discussion or citation of any authority) allowed such recovery,[60] and denied recovery of the brokerage commissions.[61]

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54. Stevens v. Lyford, 7 N.H. 360 (1834); Durkee v. Mott, 8 Barb. 422 (N.Y. App. Div. 1850).

55. It is objected, also, that the court instructed the jury, that the plaintiff was entitled to damages for his trouble in making journies to obtain the contract. . . . [Expectation damages] was all he would have received, in the ordinary course of business, had the defendant performed his contract. . . . He was not, therefore, entitled to recover any thing for the journies he had made, or the trouble of advancing money . . . .

Stevens, 7 N.H. at 367.

> The time the plaintiff spent in making the contract, is not properly an item in the assessment of damages. Where there is no fraud, and no express agreement to that effect, I am not aware that any thing antecedent to the closing of the bargain can be allowed as damages for breaking it. The contract takes effect from that time.

Durkee, 8 Barb. at 427.

56. Insley v. Shepard, 31 F. 869 (C.C. Ill. 1887).

57. Hubbard v. Epworth, 36 N.W. 801 (Mich. 1888). "It may not be easy to say what damages can be recovered on a contract terminated by forfeiture; but it is very certain that defendants have no concern with the compensation paid by the plaintiffs to their own agents for negotiating the sale." *Id.* at 803.

58. 23 N.Y.S. 158 (Sup. Ct. 1893).

59. 4 Daly 543 (N.Y. Sup. Ct. 1873).

60. A later New York opinion noted that "in the case of *Hening v. Punnett* . . . the court, without discussion or citation of authority, held that . . . [the plaintiff] was entitled to recover as damages the commissions which he had [pre-contractually] paid his broker." Empire Realty Corp. v. Sayre, 107 A.D. 415, 421 (N.Y. App. Div. 1905).

61. *Steers*, 23 N.Y.S. at 159.

> In general, I do not see a connection between the paying of the commission and the breach of the contract . . . . The payment was solely personal to the

A couple of additional opinions were issued in the decade subsequent to *Steers* that involved claims raised in the expectation damages award context and that again suggested general judicial hostility to recovery of pre-contractual expenditures.[62] The next major ruling in the reliance damages context also came from New York and drew heavily upon the rationale of *Steers*.[63] *Empire Realty Corp. v. Sayre*[64] again involved the question of recovery of pre-contractual brokerage commissions. After discussing the matter at some length, the court there concluded that the *Steers* court had properly resolved the issue against such recovery and that the earlier *Hening* case had been incorrectly decided.[65] A number of post-*Empire* decisions handed down during the following quarter-century closely followed the position taken in the *Empire* case.[66]

The year 1932 was a watershed with regard to the issue of the recoverability of pre-contractual expenditures as an element of a reliance damages award. As previously discussed, the case law before that time was almost unanimously opposed to allowing such recovery. In that year, however, two important cases were decided that took opposing positions. *Chicago Coliseum Club v. Dempsey*,[67] a very visible case involving a nationally-known boxing figure, was decided in a fashion that generally followed the prior authority. *Security Stove & Manufacturing Co. v. American Railway Express Co.*[68] took the opposing position that had been first adopted in the 1873 *Hening* case. These two opinions have been the fount for the subsequent development of two divergent lines of authority. Each of these two seminal cases, however, involved certain

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> plaintiffs, and not within, and not touching, the contract relations of the parties. It could not have been claimed if the contract had been performed, and the nonperformance does not give a right to it.

Id.

62. Halliday v. Lesh, 85 Mo. App. 285 (1900); Peck-Hammond v. Heifner, 33 So. 807 (Ala. 1903).

63. Empire Realty Corp. v. Sayre, 107 A.D. 415 (N.Y. App. Div. 1905).

64. *Id.*

65. *Id.* at 377.

> Only one case has been called to our attention where the court has enlarged the measure of damages . . . so as to permit recovery which would include the [pre-contractual] commissions paid to a broker. That is the case of *Hening v. Punnett* . . . [where] the court, without discussion or citation of authority, held that he was entitled to recover as damages the commission which he had paid his broker. . . . [In *Steers v. Laird*, however,] the court held that they could not recover the commission, and the language of Chief Judge Sedgwick in that opinion commends itself to us. . . . [T]he broker's commissions in the present case . . . were paid, not to carry out, but to procure the contract. . . . The return of the commissions could not have been claimed if the contract had been performed, and the nonperformance of it does not give a right . . . to recover them . . . .

Id.

66. *See, e.g.*, Curran v. Smith, 149 F. 945 (3d Cir. 1906); Schatzinger Consol. Realty Co. v. Stonehill, 19 Ohio C.C. (n.s.) 403 (1912); Kennedy v. Meilicke Calculator Co., 155 P. 1043 (Wash. 1916); Linde v. Ellis, 6 S.W.2d 1089 (Ky. 1928); Goodall v. Accumulative Income Corp., 240 N.W. 534 (Minn. 1932); Odem Realty Co. v. Dyer, 45 S.W.2d 838 (1932).

67. 265 Ill. App. 542 (1932).

68. 51 S.W.2d 572 (Mo. Ct. App. 1932).

particular complications that make it difficult to infer a clear legal position on this question from the opinion.

Let me discuss these two important cases in some detail. *Security Stove* involved a suit for breach of a shipping contract by a common carrier.[69] The plaintiff had sought to exhibit a specially designed oil and gas furnace at an Atlantic City trade convention. It first incurred expenditures for the rental of an exhibition booth at the convention. It then wrote the defendant, stating that it had engaged an exhibition booth, and sought to arrange timely shipment of the equipment. The parties subsequently contracted for shipment, and the defendant later breached the contract by its undue delay in delivery. The plaintiff did not seek to recover its lost profits, as they were highly uncertain and speculative, and sought instead to recover its reliance expenses, including its pre-contractual expenditures for rental of the exhibition booth. The *Security Stove* court allowed recovery of the pre-contractual outlays,[70] stating its view of the matter at some length:

> While it is true that plaintiff already had incurred some of these expenses, in that it had rented space at the exhibit before entering into the contract with defendant for the shipment of the exhibit and this part of plaintiff's damages, in a sense, arose out of a circumstance which transpired before the contract was even entered into, yet, plaintiff arranged for the exhibit knowing that it could call upon defendant to perform its common law duty to accept and transport the shipment with reasonable dispatch. The whole damage, therefore, was suffered in contemplation of defendant performing its contract, which it failed to do, and would not have been sustained except for the reliance by plaintiff upon defendant to perform it. It can, therefore, be fairly said that the damages or loss suffered by plaintiff grew out of the breach of the contract, for had the shipment arrived on time, plaintiff would have had the benefit of the contract, which was contemplated by all parties, defendant being advised of the purpose of the shipment.[71]

One reasonable reading of the *Security Stove* opinion is that it broadly endorses recovery of pre-contractual expenditures if it was within the contemplation of both parties to the contract, at the time of contract formation, that those expenditures would likely be wasted in the event of breach. This broad reading, however, might be challenged on the basis of the emphasis given by the opinion to the common-law duties borne by common carriers.[72] One could argue that *Security Stove* should perhaps be read more narrowly to endorse recovery of pre-contractual expenditures only where the plaintiff's anticipation of a subsequent contract when he makes the expenditures is grounded in a recognition that the other party may, as a common carrier (or for other special reasons), be

69. *Id.* at 573.
70. *Id.* at 577.
71. *Id.*
72. *Id.*

subject to tort liability should it fail to accept a reasonable offer to purchase its services. I think the better view, however, is that the existence of a potential tort claim for breach of the common-law common carrier duty to serve, should negotiations fail to lead to a contract, is not relevant to the allocation of responsibility for pre-contractual expenditures should the contract be subsequently made and then breached. I therefore favor the broader reading of the *Security Stove* opinion—one that provides general support for recovery of pre-contractual expenditures, given recognition by the defendant at the time of contracting that those expenditures would be wasted in the event of breach—as more in accord with the spirit of the opinion.

The plaintiff in *Dempsey*[73] had entered into a contract with Jack Dempsey, at that time the world heavyweight boxing champion, to stage a defense of his title against the challenger, Harry Wills.[74] Prior to entering into the contract with Dempsey, the plaintiff had first entered into a contract with Wills under which it was to place $50,000 into an escrow account, to be paid over to Wills ten days before the date of the boxing contest. Dempsey subsequently repudiated the contract with the plaintiff in order to engage instead in a (now famous) unsuccessful title defense against Gene Tunney, another challenger.

The plaintiff sued Dempsey, seeking damages for breach of contract. It was denied recovery of its expected profits on the ground that they were too speculative and uncertain.[75] The plaintiff further sought to recover its pre-contractual expenses, i.e., the $50,000 it was obligated to pay to Wills. The court also denied recovery of this sum.[76] While it did not refer to the authority of the line of cases supporting *Empire*, it embraced in substance the position taken in those precedents, stating as follows:

> The action is based upon the written agreement . . . [between the plaintiff and Dempsey]. Any obligations assumed by the plaintiff prior to that time are not chargeable to the defendant. Moreover, an examination of the record discloses that the $50,000 named in the contract with Wills, which was to be payable upon a signing of the agreement [between the plaintiff and Dempsey], was not and never has been paid. There is no evidence in the record showing that the plaintiff is responsible financially, and, even though there were, we consider that it is not an element of damage which can be recovered for breach of the contract in question.[77]

This case is generally regarded by courts and commentators as standing for the broad proposition that pre-contractual expenditures are not recoverable as an element of reliance damages.[78] The *Dempsey* court's dis-

73. Chicago Coliseum Club v. Dempsey, 265 Ill. App. 542 (1932).
74. *Id.* at 545.
75. *Id.* at 550.
76. *Id.* at 551.
77. *Id.*
78. *See, e.g.*, Steinberg v. Chicago Medical Sch., 354 N.E.2d 586, 591 (Ill. App. Ct. 1976) ("[*Dempsey*] is a leading case for the proposition that expenses incurred during preliminary negotiations to procure a contract are not recoverable as damages."); Moore v.

cussion of the possibility that those expenditures may not in fact have been made is thus implicitly regarded as irrelevant dicta. One could, however, reasonably characterize the rationale of the opinion quite differently. The denial of recovery could be regarded as grounded more narrowly upon the plaintiff's failure to prove its alleged losses, and the discussion of whether pre-contractual expenditures would be recoverable, had they been incurred in fact, could be regarded as mere dicta that perhaps did not reflect full judicial consideration of the question because it was not crucial to the result reached.

Only a limited number of American opinions have dealt with this question since *Security Stove* and *Dempsey* were decided in 1932, and most of them adopt the *Empire* and *Dempsey* position,[79] although they usually do not cite either of those supporting opinions directly. For example, in *Gruber v S-M News Co.*[80] the plaintiff was a manufacturer of greeting cards that sued a buyer for breach of contract. Unable to sustain a claim for lost profits, the plaintiff sought to recover his reliance expenditures, including the funds he had expended prior to the contract to make the plates from which the cards were printed. The court allowed recovery of the plaintiff's post-contractual reliance outlays, but denied recovery for the cost of manufacturing the plates, stating that those costs were not recoverable because the plates "had already been fabricated prior to making the contract with defendant."[81]

Another opinion that implicitly adopted the *Dempsey* position is *Hough v. Jay-Dee Realty & Investment, Inc.*[82] The plaintiff and defendant in that case had entered into a contract under which the plaintiff was to lease a building from the defendant and operate it as a restaurant. After entering into a preliminary oral agreement with the defendant, but before the signing of the formal, legally enforceable contract, the plaintiff incurred a number of expenses associated with his travel and other activities intended to establish business relationships with suppliers of food, fixtures and equipment, and to obtain financing for these later anticipated purchases. The defendant subsequently breached the contract, and the plaintiff sought to recover those pre-contractual outlays rather than his prospective lost profits. The *Hough* court reduced a prior jury award that was favorable to the plaintiff so as to deny this element of the claim.[83]

Lewis, 366 N.E.2d 594, 599 (Ill. App. Ct. 1977) (dicta citing *Dempsey* for this proposition); FARNSWORTH, *supra* note 1, at 928 n.2.

79. As the rationale of the Dempsey opinion is conventionally understood; *see supra* text accompanying note 78.

80. 126 F. Supp. 442 (S.D.N.Y. 1954).

81. *Id.* at 446-47. The *Gruber* opinion did not refer to either the *Security Stove* or *Dempsey* precedents.

82. 401 S.W.2d 545 (Mo. Ct. App. 1966).

83. *Id.* at 550.

> [W]e have the view that no allowance should have been made for the [expenses incurred during the pre-contractual] period. . . . Plaintiffs' expenditures during that period were not referable to the contract or its breach. Expenses incurred during preliminary negotiations are not usually recoverable in an action for breach of contract . . . and in this case they were in-

Other recent opinions that accept the substance of the *Dempsey* position, but that relate back more directly to *Empire*-type rulings that pre-contractual brokerage commissions are not recoverable, are *Manning v. Pounds*[84] and *Cacavas v. Zack*.[85]

There are also, however, several American post-*Security Stove* cases that can be read as supporting the position that pre-contractual expenditures may be recoverable. For example, *French v. Nabob Silver-Lead Co.*[86] involved a dispute concerning a mining lease contract. The plaintiff had been performing its duties under a prior lease contract with the defendant and sought to obtain a two-year extension of that lease. The defendant made clear during the negotiations for the lease extension that, due to its own requirements, it would be unable to continue to provide the plaintiff with compressed air for use in mining operations on the lease during any extension period. The plaintiff subsequently made arrangements with another mining company for an alternative compressed-air airline to be installed to access the leased property. Much of the work on this airline was done while the lease extension was still being negotiated. The plaintiff and the defendant subsequently entered into a second contract that provided for a two-year lease extension. The defendant breached this second contract, and the plaintiff sued, seeking to recover the approximately $1500 it had expended on the construction of the airline before that lease extension contract was made. The Idaho Supreme Court in *French* allowed recovery of this sum,[87] stating: "The airline was built in anticipation of a new lease in accordance with the suggestion of [defendant's] officers. Expenses incurred by a party in anticipation of or preparation for performance of a contract may be recovered as damages in an action for a breach thereof."[88]

The *French* opinion is another case that, like *Dempsey*, is susceptible to sharply conflicting interpretations as to its proper scope of application. The opinion can be read broadly as endorsing the recovery of pre-contractual expenditures whenever the defendant can reasonably anticipate

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curred before any enforceable obligation arose, since the contract was required by the Statute of Frauds to be in writing.

Id. Neither *Security Stove* nor *Dempsey* are cited in this opinion, although the *Hough* court does refer for support to the *Corbin on Contracts* treatise and to a section of the *American Jurisprudence* legal encyclopedia, and these cited secondary sources in turn refer to the above seminal cases. *See* CORBIN, *supra* note 1, § 1034; 22 AM. JUR. 2D *Damages* § 158.

84. 199 A.2d 188 (Conn. App. Ct. 1963).

85. 203 N.W.2d 913 (Mich. Ct. App. 1972). *Cacavas* was cited approvingly in a recent case as standing for the proposition that pre-contractual expenditures are not, in general, recoverable as damages for breach. Autotrol Corp. v. Continental Water Sys. Corp., 918 F.2d 689, 695 (7th Cir. 1990). *Cacavas* has also been cited, however, as supporting the opposite position that pre-contractual expenses are recoverable if within the reasonable contemplation of the parties, an interpretation that the language of the opinion does not appear to support. Device Trading Ltd. v. The Viking Corp., 307 N.W.2d 362, 366 (Mich. Ct. App. 1980) ("[pre-contractual expenditures] are not recoverable unless within the reasonable contemplation of the parties").

86. 350 P.2d 206 (Idaho 1960).

87. *Id.* at 210.

88. *Id.*

at the time of contract formation that they are likely to be wasted as a result of his breach. Alternatively, given that the parties in *French* were already in a prior contractual relationship at the time they were negotiating the lease extension contract that was subsequently breached, the opinion can be read more narrowly as endorsing recovery of pre-contractual expenditures only under the limited circumstance where they are made while the parties are operating under a prior, closely related contract. The *French* court's statement of the governing principle in the form of the hornbook phrase "expenses incurred in anticipation of or preparation for performance of a contract" ambiguously straddles these two possibilities. Does the court mean by this phrase to include all pre-contractual expenses incurred "in anticipation . . . of a contract," or only those expenses incurred "in anticipation of . . . performance of a contract" once that contract or a closely related prior contract is in force?

Statements made by the same Idaho Supreme Court a quarter-century later in its opinion in *Brown v. Yacht Club of Coeur D'Alene, Ltd.*[89] suggest that the later, narrower interpretation of *French* is the appropriate one. The *Brown* court cites *French* for the proposition that "damages for breach of contract may include expenses incurred by a party in anticipation of or preparation for performance,"[90] thus implicitly rejecting the broader "anticipation . . . of a contract" interpretive possibility left open by *French*. The *Brown* case also contains the statement that a reliance interest-based recovery is available for "all expenses reasonably related to the purposes of the contract, which would not have been incurred but for the contract's existence."[91] This "but for" language further suggests that the Idaho Supreme Court now rejects the principle of recovery of pre-contractual expenditures, even if grounded in a relationship growing ouf of a prior, closely-related contract, if in fact it ever consciously embraced that principle.[92]

An opinion that clearly embraces the *Security Stove* position is *Norton & Lamphere Construction Co. v. Blow & Cote, Inc.*[93] In that case the plaintiff, prior to entering into a contract with the defendant to sell to it crushed rock, purchased rock crushing and loading equipment for use on all of its prospective contracts. The defendant did not have any notice at the time of contracting as to these prior purchases by the defendant. The plaintiff subsequently sought to recover these pre-contractual outlays as an element of damages for breach. The *Norton* court denied recovery of those outlays, but did so through application of a standard that would allow recovery of pre-contractual outlays in many instances:

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89. 722 P.2d 1062 (Idaho 1986).

90. *Id.* at 1067.

91. *Id.*

92. *See also* King v. Beatrice Foods Co., 402 P.2d 966, 968 (Idaho 1965) (citing *French* for the narrow proposition that "[t]he injured party may recover the reasonable expense which he has incurred in anticipation of performance").

93. 183 A.2d 230 (Vt. 1962).

> Damages resulting to a plaintiff, for failure to meet the terms of a contract . . . before contractual relations existed with the defendant, and of which agreement defendant had no knowledge, are not the direct and natural results of a breach. . . . [The pre-contractual expenditure] was not a circumstance known to the defendant, nor one which could reasonably be supposed to have been in its contemplation at the time it contracted with the plaintiff. It was a circumstance which was not considered by both parties when the contract was made which was necessary for it to bring it within the rule of damages.[94]

The *Norton* opinion thus lends support to the view that pre-contractual expenditures may be recoverable if their wastage in the event of breach is in the reasonable contemplation of both parties to the contract at the time of formation.

Finally, in *Coastland Corp. v. Third National Mortgage Co.*[95] the Fourth Circuit Court of Appeals allowed a plaintiff developer to recover one-half of its pre-contractual outlays for architectural, engineering and attorney fees when the defendant lender failed to honor the terms of a permanent financing commitment.[96] After noting that a party in breach was liable for such damages as are the "reasonable and natural consequences of the breach under the circumstances so disclosed and as may reasonably be supposed to have been in the contemplation of both parties,"[97] the court allowed recovery, stating:

> [Defendant] was provided with documentation at the time Coastland applied for construction and permanent financing that included Coastland's expected total expenditures for architectural, engineering and legal services. . . . Consequently, [defendant] was aware that those expenses were or would be incurred by Coastland and, further, that a breach of its commitment to provide the construction financing might cause Coastland to suffer damages in the amount expended for such services. . . . In light of the above, we do not think the district court erred in including expenditures made by Coastland prior to the time the construction financing commitment was given when awarding Coastland one-half of the expenses it incurred in preparation for the construction of the project . . . .[98]

In summary, there is a line of United States case law extending back over a century that supports the position that pre-contractual expenditures may not be recovered as an element of reliance damages. There also exists, however, a second and more recent line of cases, also having

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94. *Id.* at 236.

95. 611 F.2d 969, 979 (4th Cir. 1979).

96. *Id.* at 979. It is not entirely clear why the *Coastland* court elected to allow recovery of precisely one-half of the pre-contractual expenditures, rather than all of them or none of them. The lower court had allowed Coastland Corporation to recover one-half of its anticipated profits under the contract, as well as one-half of the pre-contractual expenditures. *Id.* at 978. That award of one-half of the lost profits was reversed on appeal, but the award of one half of the pre-contractual expenditures was allowed to stand. *Id.* at 979.

97. *Id.* at 979.

98. *Id.*

discernible nineteenth-century roots but commencing essentially with the 1932 *Security Stove* opinion, that embraces the contrary position that such expenditures may under certain circumstances be recoverable.

V. AN APPROPRIATE STANDARD FOR RESOLVING CLAIMS FOR PRE-CONTRACTUAL EXPENDITURES

A. Possible Candidates for a Standard

If one accepts the argument that some categories of pre-contractual expenditures should, at least under some circumstances, be recoverable as part of a reliance damages award, then the question becomes one of determining the appropriate standard for making those decisions. A number of reasonable candidates appear to be available for use as a criterion. Let me briefly describe six of the more appealing alternatives, which I will then discuss and compare.

i) The plaintiff could be limited to recovering his pre-contractual conveyancing and title investigation expenses in the context of breaches of real estate contracts. This is the standard long embraced by the *Hanslip-Wallington* line of English cases.[99] Let me call this narrow criterion the "Conveyancing Expenses" standard.

ii) As a somewhat broader principle of recovery, the plaintiff could be permitted to recover not only the above-noted conveyancing expenses, but also those pre-contractual expenses incurred in performing duties that were ultimately required under the subsequent contract, whether or not the contract involved the conveyance of real estate. This is the standard embraced by the *Lloyd v. Stanbury*[100] opinion, if that case is read broadly enough to extend to cover pre-contractual expenditures made outside of the real estate context, but not so broadly so as to extend to expenditures not subsequently required by the contract. Let me call this criterion the "Required Expenditures" standard.[101]

iii) As an even more expansive standard, the plaintiff could be allowed to recover all of his pre-contractual expenditures related to the contract that occurred after the parties had reached complete agreement on all of the terms of the contract, but before the formalities of execution had been completed. No court of which I am aware has yet embraced this particular standard. Let me call this criterion the "Full Informal Agreement" standard.

iv) Closely related to the above standard would be a slightly more liberal standard that would allow recovery of pre-contractual expenditures

99. Hanslip v. Padwick, 5 Ex. 615, 155 Eng. Rep. 269 (1850); Wallington v. Townsend, 1 Ch. 588 (1939).

100. 1 W.L.R. 535 (1971).

101. This is the standard endorsed by the New Zealand commentator David Grinlinton in his article on the subject: "[T]here is no justification in principle or practice to extend the law of damages in contracts for the sale of land to pre-contractual expenditure beyond the limits established in *Lloyd v. Stanbury*." Grinlinton, *supra* note 15, at 52 (footnote omitted).

once the parties had reached substantial agreement on the major terms of their contract, even when further negotiation of subsidiary terms took place before a formal contract was entered into. Let me call this criterion the "Substantial Agreement" standard.[102]

v) More expansively yet, the plaintiff could be allowed to recover all of his pre-contractual expenditures that were, at the moment of contract formation, within the reasonable contemplation of the parties as losses that the plaintiff would bear if the contract was breached. This is the standard adopted by the *Anglia* court and by subsequent courts that have followed that opinion.[103] Let me call this criterion the "Reasonable Contemplation" standard.

vi) Finally, and most expansively, the plaintiff could be allowed to recover all pre-contractual expenditures that were related in any way to the contract subsequently breached. Let me call this very broad criterion the "Contract-Related" standard.

Recovery of pre-contractual expenditures under any of these standards would presumably be subject to the usual avoidability,[104] foreseeability,[105] and reasonable certainty[106] limitations on damages. Furthermore, any of these standards would apply only as a "default rule"; the parties would be free to substitute an alternative regime for allocating damages in the event of breach should they elect to do so in their agreement.[107] In addition, any recovery should continue to be subject to the generally accepted "losing contract" limitation that mandates that a reliance damages recovery may not exceed the size of the plaintiff's hypothetical expectation interest-based recovery, but must be reduced by the amount of any losses that would have resulted under the contract if fully performed.[108]

B. Advantages of the "Reasonable Contemplation" Standard

The first two of these six alternatives seem clearly to be inferior means of facilitating fully compensatory reliance damages awards. The very re-

102. Such a standard has been suggested by the British commentator A. I. Ogus. Ogus, *supra* note 2, at 349-50; *see also* Ogus, *supra* note 43. Ogus has been critical of the *Anglia* decision: "The award in *Anglia Television v. Reed* is unsatisfactory in that it is consistent neither with reliance interest compensation nor with expectation interest compensation but reveals an unhappy confusion between the two." Ogus, *supra* note 43, at 426.

103. Anglia Television Ltd. v. Reed, 1 Q.B. 60 (C.A. 1972) (Eng.); C.C.C. Films (London) Ltd. v. Impact Quadrant Films Ltd., 1 Q.B. 16 (1985) (Eng.); Fieling v. Newell, 1986 Outer House Cases (Sess. Nov. 28, 1986) (Scot.) (LEXIS Intlaw Library, Scocas file); O'Connell v. Hay, Dunedin Registry, A. 48/82 (Feb. 4, 1983) (N.Z.), *cited in* MacLauchlan, *supra* note 43, at 360.

104. *See, e.g.*, Farnsworth, *supra* note 1, at 896.

105. *Id.* at 912.

106. *Id.* at 921-22.

107. It does, however, appear unlikely that in practice very many contracting parties would elect to spend the time necessary to specify in their agreement what damages were to be awarded in the relatively unlikely event that a reviewing court would choose to award reliance damages rather than expectation damages, particularly with regard to the recoverability of pre-contractual outlays.

108. John Calamari & Joseph Perillo, Contracts 604 (3d ed. 1987).

strictive Conveyancing Expenses standard is too narrow to apply in most instances where a conventional reliance damages award limited to post-contractual expenditures would undercompensate the plaintiff. Even in those few cases where it might apply, it would generally provide only a relatively small amount of additional compensation that is likely to be insufficient to offset significantly the consequences of disregard of the value of post-contractual forgone opportunities. The Required Expenses standard, while being of somewhat broader applicability than the Conveyancing Expenses standard, is still very narrow in scope, and also would not apply in the large majority of instances in which pre-contractual expenses were incurred.

The Full Informal Agreement standard also has major shortcomings. It does have the advantage of being grounded in a modest and intuitively appealing extension of traditional reliance principles: that the promisee has the right to commence relying upon the promisor's commitment once all of its terms are clearly established, and need not await the completion of the mere formalities of execution. The main difficulty with this standard, however, is again that it is potentially under-inclusive. It would operate to deny recovery where the expenditures occurred prior to an agreement, or even after the parties have reached essential agreement on all major terms, but where some minor points of disagreement remain to be negotiated.

The under-inclusiveness problem of the Full Informal Agreement standard could be partially avoided by use of the Substantial Agreement standard. That standard would allow recovery for pre-contractual expenditures once the parties have informally assented to a core agreement on essential terms. It would not, however, allow recovery for expenditures made in anticipation of an agreement but before the core terms of that agreement were informally in place.[109] It thus also is potentially under-inclusive.[110] In addition, it would be difficult to develop consistent guidelines as to which terms of a contract qualified as "major" terms that must be agreed to before pre-contractual expenditures could be recoverable.

The Contract-Related standard, while it would certainly be of very broad applicability, has a serious disadvantage in that it would necessitate a difficult and detailed inquiry into the plaintiff's pre-contractual conduct. It would be quite an undertaking to ascertain which of the plaintiff's overhead and other general expenses were "related to" the subject contract and therefore recoverable. Moreover, any such expenditures would be subject to the usual *Hadley v. Baxendale*[111]-based limitation that they be reasonably foreseeable to the defendant at the time of contracting as losses that would likely result from breach. Given this foreseeability limitation on recovery, the Contract-Related standard would, in

109. McLauchlan, *supra* note 43, at 354.
110. *Id.*
111. 156 Eng. Rep. 145 (1854).

practice, be reduced to the more restrictive Reasonable Contemplation standard. This being the case, it would be more sensible to utilize that latter standard directly, and thus avoid the need for engaging in a pointless inquiry into the nature of the plaintiff's pre-contractual overhead costs and other such expenditures.

The Reasonable Contemplation standard seems to me to be by far the most appealing option. First, it has an attractive normative foundation. The standard is implicitly based upon the principle that even though pre-contractual expenditures do not occur in reliance upon the later-formed contract, at the moment of contracting those expenditures are irrevocably committed to the objective of contract performance by the plaintiff, and will subsequently be wasted if the contract is breached (subject to any available mitigation opportunities). This is generally understood by both parties as one of the consequences of entering into the agreement. In other words, while the pre-contractual expenditures are not made in reliance upon the contract per se, the commitment of the expenditures to the contract and their subsequent wastage upon breach do occur in reliance upon the agreement.[112] The pre-contractual expenditures become thereby incorporated into the domain of post-contractual compensable reliance behavior by dint of their reasonably foreseeable conversion into wasted expenditures upon breach.

Second, this standard seems broad enough to apply to many kinds of pre-contractual expenditures. It thus promises to mitigate the reliance damages undercompensation problem in a substantial proportion of the cases in which that problem arises. Third, and perhaps most importantly, this standard seems to mesh quite well with existing limitations as to the scope of application of a principle of recovery. There is obviously a very close parallel between this standard and the "reasonable foreseeability" limitation on liability for consequential damages deriving from *Hadley v. Baxendale*.[113] Just as the defendant is liable under the *Hadley*-based law only for those possible future consequences of breach that are reasonably foreseeable to him at the time of contracting, he would under the Reasonable Contemplation standard be liable for only those pre-contractual expenditures for which he can reasonably foresee at the time of contracting that they will be wasted in the event of breach. While the foreseeability limitation would here apply to already-incurred expenditures rather than to possible future consequential losses, the manner of application of this limitation would be precisely analogous, and all of the jurisprudence of foreseeability limitations could be applied without significant alteration. Moreover, the Reasonable Contemplation standard would also operate as a useful "information-forcing" default rule that facilitates

112. For further elaboration of this argument, see McLauchlan, *supra* note 43, at 355-56.

113. 156 Eng. Rep. 145 (1854).

communication during negotiations in the same fashion as does the foreseeability limitation.[114]

The avoidability principle denying recovery for losses that could have been avoided without undue burden after breach could also be directly applied under this standard. That principle would be applied here so as to focus on whether the pre-contractual expenditures could have been devoted to a beneficial alternative use, once the promisee learned of the promisor's breach. Such an analysis would exactly parallel the standard inquiry concerning the avoidability of post-contractual expenditures, or concerning the prospects for salvage of post-contractual expenditures, in which courts now engage.

The reasonable certainty limitation on recoveries would likely not have significant effect here, since the pre-contractual expenditures will usually be adequately documented. If, however, one were to define the Reasonable Contemplation standard more broadly to be inclusive of compensation for the value of pre-contractually forgone opportunities, that certainty limitation would then have considerable bite. As previously discussed, the usual context in which reliance damages are sought is where the expected profits under the breached contract cannot be established with the requisite degree of certainty,[115] and courts have shown an extreme unwillingness to attempt to value and compensate for post-contractually lost opportunities in that context.[116] Given this fact, it seems unlikely that a plaintiff could establish the value of pre-contractually forgone opportunities with the required degree of certainty.[117] The Reasonable Contemplation standard, even if it nominally covered pre-contractually forgone opportunities, would in all likelihood be applied to allow recovery only of documented pre-contractual expenditures.[118] Given that the certainty limitations would preclude recovery of the value of the forgone opportunities, I have elected to expressly limit my proposed Reasonable Contemplation standard to pre-contractual expenditures.

The express exclusion of recovery of the value of pre-contractually forgone opportunities from the proposed standard may seem somewhat incongruous, given that forgone opportunities are economically equivalent to expenditures, and given that the proposal is motivated by the failure of courts to compensate for forgone post-contractual opportunities in reliance damages awards. However, while the argument made in this article is premised upon the need to find an adequate proxy measure to substi-

114. *See generally* Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 97-100 (1989).

115. FARNSWORTH, *supra* note 1, at 928.

116. Pettit, *supra* note 1, at 457.

117. But see Ash v. Victor Enters., Auckland Registry, A. 591/70 (Aug. 5, 1974) (N.Z.) (Coola, J.), cited in McLaughlan, *supra* note 43, at 357, and discussed *supra* at text accompanying notes 50-53, where the value of the pre-contractually forgone receipts were established with certainty.

118. See *id.*, where the court elected not to apply the rationale of *Anglia* to allow recovery of the value of pre-contractually forgone receipts.

tute for the uncertain value of post-contractually forgone opportunities, and proposes using certain pre-contractual expenditures as that proxy measure, no similar maneuver seems possible to deal with the analogous lack-of-certainty problem that would arise if other pre-contractual conduct is considered. In other words, while a reasonable proxy measure appears to be available for the value of post-contractual lost opportunities—the "reasonably contemplated as wasted in the event of breach" pre-contractual expenditures—no comparable expenditure measure appears to be available that might suffice as a proxy measure for the value of the pre-contractually forgone opportunities. As a result, I have elected to exclude recovery of the value of pre-contractually forgone opportunities from my proposal. This exclusion admittedly limits the ability of the Reasonable Compensation standard to offset the systematic undercompensation problem inherent in conventional reliance damage awards. I do not, however, see any better way to address this problem without wholly departing from existing judicial precedent and engaging in a more radical re-examination of the certainty limitations themselves, a task which is beyond the scope of this paper.

The question remains, even given all of the limitations incorporated by the Reasonable Contemplation standard, whether it still might apply perversely in some circumstances so as to overcompensate the plaintiff, relative to what he would have recovered under a theoretically sound reliance damages award that included directly the value of post-contractually forgone opportunities. Would this standard ever work to overcompensate a plaintiff by allowing him to recover pre-contractual expenditures in excess of the value of post-contractual forgone opportunities that are overlooked in current reliance damages awards? This possibility seems to me to be rather remote. In most instances the plaintiff will likely be able to document only a relatively small sum of pre-contractual expenditures that are wasted as a reasonably foreseeable consequence of breach. This sum is likely to be significantly less than the value of opportunities forgone in post-contractual reliance upon the contract. Moreover, overcompensation is even less likely to occur when the recovery allowed is compared to the plaintiff's expectation interest. It is rare that a party to a contract does not reasonably expect the contract to yield proceeds at least sufficient to cover his contract-related pre- and post-contractual expenditures. A plaintiff will not usually regard it as a windfall gain to recover merely his documented expenditures in a successful action for breach, and will generally view a reliance interest-based recovery, even if it is augmented by allowance of pre-contractual expenditures, as a poor substitute for the loss of profits that would have been recovered had his expectation interest been protected.

Finally, any recovery calculated under this standard will presumably be subject to the usual "losing contract" limitation that a reliance damages award may not exceed the hypothetical expectation recovery, i.e., must be reduced by the amount of any losses that the plaintiff would have in-

curred under the contract.[119] This limitation will serve to prevent promisees from using this new doctrine to shift responsibility for the burden of losing contracts onto breaching promisors.

In summary, the Reasonable Contemplation standard appears to provide a workable means for mitigating to some substantial extent the problem of systematic undercompensation exhibited by conventional reliance damage awards, without going to the other extreme of overcompensating promisees.[120] It will certainly reduce the size of the reliance damages undercompensation gap more effectively than would use of any of the other alternative standards here considered, and would do so in a measured fashion harnessed by the entire body of jurisprudence of recovery limitations so far developed to avoid awarding overcompensation in various contexts. Let me now briefly reassess the Commonwealth and American case law on this issue in light of this proposed standard.

C. Reconsideration of the Case Law in Light of the Reasonable Contemplation Standard

1. The Commonwealth Cases

The application of the Reasonable Contemplation standard in the pre-1971 cases that denied recovery of pre-contractual expenditures would almost certainly have changed their results. The recovery of pre-contractual title investigation and conveyancing expenses that was allowed in the *Hanslip* and *Wallington* conveyancing expenses exception cases would also have been allowed had those cases been decided under the Reasonable Contemplation standard, but the anachronistic limitation of recovery to the real estate conveyance context would be discarded.

With regard to *Lloyd* and *Anglia* and the subsequent cases that have followed those precedents to allow recovery, use of the Reasonable Contemplation standard would yield results identical to those actually reached, but would in some instances ground those holdings upon a more satisfactory rationale. The pre-contractual expenditures that were subsequently required by the contract and that were allowed as an element of the recovery by the *Lloyd* court would certainly be regarded as being in the reasonable contemplation of the parties wasted upon breach as much as would be any post-contractual reliance expenditures. The *Anglia*

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119. Calamari & Perillo, *supra* note 108, at 604.

120. In full accord with this conclusion is the New Zealand scholar D. W. McLauchlan:

> [T]he real issue . . . is whether the basic rule of contract damages that a plaintiff is entitled to recover in respect of *losses caused by the breach which are within the reasonable contemplation of the parties at the time of the contract* can be satisfied in the case of the pre-contract expenditure. . . . There can be no justification for treating pre-contract expenditure any differently from post-contract expenditure.

McLauchlan, *supra* note 43, at 355 (emphasis in original). "The real issue is whether such an award [of pre-contractual expenditures] can be accommodated within the fundamental rule of contract law damages that reasonably contemplated losses caused by a breach of contract are recoverable. . . . The answer to this question must be in the affirmative." *Id.* at 361.

court, of course, expressly adopted the essence of the proposed Reasonable Contemplation standard, as did the *C.C.C. Films* court, the *Fieling v. Newell* court, and the New Zealand opinion of *O'Connell v. Hay*. In my opinion the Commonwealth case law since *Lloyd* and *Anglia*, though still somewhat sparse in extent, is clear and consistent enough to justify the assertion that the Commonwealth courts now embrace the substance of my proposed Reasonable Compensation standard.

2. The United States Cases

As I have discussed above, American judges are much more divided over the issue of recovering pre-contractual expenditures than are their Commonwealth counterparts, with the traditional "no recovery" position now being challenged by a modest minority line of cases that allow, or at least admit the possibility of allowing, such recovery. The precise position embraced by this minority line of cases is not entirely clear, but it seems roughly consistent with the Reasonable Contemplation standard.

The *Security Stove* court, in allowing recovery of the pre-contractual expenditures, did not expressly embrace a broad Reasonable Contemplation principle of recovery, but its ruling is not inconsistent with the application of this standard. The opinion speaks of the parties' "contemplation," but it uses this term to refer to the fact that the plaintiff contemplated that the defendant would perform his obligations,[121] and to the fact that all parties contemplated that the plaintiff would thereby benefit.[122] The term was not used in the context of the defendant contemplating the wastage of the plaintiff's pre-contractual expenditures as a potential consequences of his breach. However, the defendant in that case had been notified at the outset of negotiations that the plaintiff had expended funds to rent an exhibition booth,[123] and could easily foresee the wastage of those expenditures should it fail to deliver the goods in timely fashion. While the *Security Stove* court arguably would have denied recovery if the case had not arisen in a common carrier context, recovery would certainly have been allowed regardless of context had the court applied the Reasonable Contemplation standard here proposed.

While the *French* court also did not speak of reasonable contemplation of the consequences of breach, it did note that the defendant was well aware of the plaintiff's plans to incur pre-contractual expenses.[124] That court would in all likelihood have allowed recovery of those expenses, and in a much clearer and less ambiguous fashion, had it applied the Reasonable Contemplation standard. The later *Norton* and *Coastland* opinions both expressly embraced the reasonable contemplation phrase and underlying principles and decided the disputes on that basis.

121. Security Stove & Mfg. Co. v. American Ry. Express Co., 51 S.W.2d 572, 577 (Mo. Ct. App. 1932).
122. *Id.*
123. *Id.* at 573.
124. French v. Nabob Silver-Lead Co., 350 P.2d 206, 207 (Idaho 1960).

Application of the Reasonable Contemplation standard would not have altered the outcome in *Dempsey*; the plaintiff would still have been denied recovery on the basis of its failure to prove its alleged expenditures.[125] This proposed standard does, however, conflict directly with the legal principle of non-recovery of pre-contractual expenditures set forth in *Dempsey*, in the long line of pre-*Dempsey* cases denying recovery, and in the post-*Dempsey* cases such as *Gruber*, *Hough*, and *Brown*. Its use would likely have changed the result in most or all of those cases.

The United States courts are split on this question, with the majority supporting denial of recovery, and to embrace the Reasonable Contemplation standard one must simply reject the reasoning of the *Empire-Dempsey* majority line of cases. I think that such a rejection is called for. Those cases reflect an unreflective and wooden understanding of the concept of reliance, and evidence no sensitivity whatever to the systematic undercompensation problem caused by the application of the certainty limitations in the reliance damages context. The Reasonable Contemplation standard more than adequately addresses any legitimate concerns raised by the allowance of recovery of pre-contractual expenditures under the reliance interest rubric.

VI. CONCLUSION

I therefore advocate the position that pre-contractual expenditures should be properly recoverable as reliance damages if the contract is subsequently breached, so long as the fact that those expenditures would likely be wasted in the event of breach was within the reasonable contemplation of the parties at the time of contract formation, and so long as the other established limitations on recovery are honored. The value of any pre-contractually forgone opportunities would not be recoverable under this Reasonable Compensation standard.

There is little danger that application of this principle of expanded recovery would go beyond mitigating the reliance damages undercompensation problem and lead to overcompensation of promisees. Recovery of pre-contractual expenditures would be subject to the usual limitations that those expenditures not be avoidable after breach without undue burden to the plaintiff, be reasonably foreseeable to the party in breach at the time of contracting, be proven with reasonable certainty as to amount, and not lead to an overall recovery that would exceed what the plaintiff would have recovered in protection of his expectation interest. Moreover, the contracting parties would be free to opt out of this standard by agreement.

The foreseeability limitation on recovery is likely to have little if any independent application under this proposed standard, since the substantively identical reasonable contemplation requirement incorporates its core principle. The reasonable certainty limitation is also likely to have

125. Chicago Coliseum Club v. Dempsey, 265 Ill. App. 542, 545-46 (1932).

little if any scope of application, given that pre-contractual expenditures can usually be documented, and given that the proposed standard expressly excludes recovery of the usually uncertain value of pre-contractually forgone opportunities.

The avoidability limitation, in contrast, may upon occasion be quite significant in determining what proportion of the pre-contractual expenditures were in fact recognized at the time of contract formation as likely to be wasted in the event of breach. This is particularly likely to be the case when the act of breach follows soon after the formation of the contract. In addition, the "losing contract" overall limitation on reliance damage awards may upon occasion serve to disallow recovery of some or all pre-contractual expenditures.

I think the Reasonable Contemplation standard provides a workable means of offsetting to a significant extent the systematic undercompensation provided by current reliance damages awards. Had this standard been applied in the relevant prior cases, it would have led to results consistent with the outcomes that were reached in the more recent Commonwealth cases, but would have grounded those results in some instances in a more satisfying rationale. It would also have yielded results consistent with those reached in the *Security Stove* line of United States cases. Its application would have changed the legal position on this question taken in the *Dempsey* opinion—though it would not have changed the outcome of that case—and would have changed both the rationale and result reached in the numerous earlier and later cases that have adopted the substance of the *Dempsey* position. This change in the law would be a change for the better. I recommend that the United States courts give serious consideration to adopting the Reasonable Contemplation standard with regard to recovery of pre-contractual expenditures as an element of reliance damages awards.