Expectation and Reliance: One Principle or Two?

David Campbell[*] *and Roger Halson*[†]

Elementary mathematics are used in this paper to clarify the 'losing contract problem' which continues to confuse courts addressing the quantification of damages for breach of contract. The distinction between gross receipts and net profits is analysed in a way which allows the coherent identification of the claimant's expectation in all contracts, be they profitable, break-even or losing contracts.

Introduction

In this short article we seek to demonstrate that the use of elementary mathematics allows us to clarify the analysis of the 'losing contract problem' which continues to confuse courts and bedevil our understanding of the conceptual foundations of the quantification of damages for breach of contract.[1] In the Commonwealth,[2] this problem was brought to prominence by Professor Ogus' comments in the early 70s[3] on *Anglia Television Ltd v Reed*,[4] and, as

---

[*] BSc(Econ), LLM, PhD, FCI(Arb), Professor of Law, Lancaster University, UK
[†] LLB, MLitt, Professor of Contract and Commercial Law, School of Law, University of Leeds, UK. We are grateful to Peter Jaffey, Anthony Ogus, the Editor and his anonymous referee for their comments. After this paper was submitted for publication we became aware of S A Smith, 'Remedies for Contract: One Principle or Two?' in G Klass et al (Eds), *Philosophical Foundations of Contract Law*, Oxford University Press, Oxford, 2014, p 341. Professor Smith does not address our concerns.

[1] A quite different but similarly elementary mathematical treatment of reliance expenditure, including the losing contract problem, is outlined in D R Harris et al, *Remedies in Contract and Tort*, 2nd edn, Cambridge University Press, Cambridge, 2002, pp 124-7, and this has found favour with the learned editor of *Chitty* in his capacity as the author of the chapter on damages: H G Beale, ed, *Chitty on Contracts*, 31st edn, Sweet and Maxwell 2012, vol 1, para 26-024.

[2] We shall not discuss the US case law following *Albert* (*L*) *& Son v Armstrong Rubber Co* 178 F 2d 182 (2nd Cir 1949) nor the US academic literature, save for Fuller and Perdue's article itself. For an overview see J M Perillo *Calamari and Perillo on Contracts*, 6th ed, Thomson West, St Paul MN, 2009, pp 500-2.

[3] A I Ogus, 'Damages for Pre-contract Expenditure' (1972) 35 *MLR* 423 and A I Ogus, *Law of Damages*, Butterworths, London, 1973, pp 350-4.

[4] [1972] 1 QB 60 (*Anglia TV*).

Professor McLauchlan's much more recent note[5] on *Omak Maritime Ltd v Mamola Challenger Shipping Co Ltd*[6] shows, it has not since been adequately understood, despite being the subject of extremely detailed examination of the principles and authorities in a number of subsequent cases, in particular *Commonwealth of Australia v Amann Aviation Pty Ltd*.[7]

The basis of the analysis of the losing contract problem remains Fuller and Perdue's distinguishing of three interests protected by the remedies for breach of contract,[8] though the clarification of the problem proposed here turns on recognising the primacy of the expectation interest in a way that cuts against the hierarchy of interests, or in Fuller's own words the 'scale of enforceability',[9] which Fuller and Perdue themselves put forward. Putting the restitution interest to one side, the expectation interest seeks to protect the profit which the claimant seeks to realise through performance of its obligations under the contract. The aim of protection of the expectation interest understood in this way is 'to put the [claimant] in as good a position as he would have occupied had the defendant performed his promise',[10] which is, of course, known in the Commonwealth as the principle in *Robinson v Harman*.[11] The reliance interest seeks to protect any investment the claimant made in (part-)performing its obligations. The aim of protecting the reliance interest 'is to put [the claimant] in as good a position as he was in before the promise was made'.[12] The losing contract problem is whether, when the claimant's expectation interest is negative but its reliance interest is

---

[5] D McLauchlan, 'The Redundant Reliance Interest in Contract Damages' (2011) 127 *LQR* 23.
[6] [2011] 2 All ER (Comm) 155; [2010] EWHC 2026 (Comm) (*Omak*).
[7] (1991) 174 CLR 64 at 80–2, 84–6, 99-101, 104–8, 126–8, 134–5, 154–6, 163. Brannan J's analysis at 99-101, 104-8 itself makes use of algebra (*Amann Aviation*).
[8] L L Fuller and W R Perdue Jr, 'The Reliance Interest in Contract Damages: 1' (1936) 46 *Yale LJ* 52.
[9] L L Fuller, 'To K N Llewellyn, 8 December 1938' in S Summers, *Lon L Fuller*, Edward Arnold, London, 1984, p 133. See further L L Fuller and W R Perdue Jr, 'The Reliance Interest in Contract Damages: 2' (1937) 46 *Yale LJ* 373 at 396.
[10] Fuller and Perdue, above, n 8 at 54.
[11] (1848) 1 Ex 850 at 855; 154 ER 363 at 365.
[12] Fuller and Perdue, above, n 8 at 54.

positive, the negative expectation extinguishes or limits a reliance claim, or whether the claimant can avoid any such extinguishing or limiting effect by treating expectation and reliance as two distinct principles and electing to claim only the latter. As Lord Denning MR put it in *Anglia TV*:[13]

> It seems to me that a plaintiff in such a case as this has an election: he can either claim for loss of profits; or for his wasted expenditure. But he must elect between them. He cannot claim both. If he has not suffered any loss of profits - or if he cannot prove what his profits would have been - he can claim in the alternative the expenditure which has been thrown away, that is, wasted, by reason of the breach.

The main value that this article is intended to have, concision in the statement of its clarification of the losing contract problem, would be defeated by any attempt to fully consider what is now a sizeable case law and a large academic literature, or to deal with all the conceptual intricacies noted therein, and we will not do so, instead focusing on an illustrative, rather than exhaustive, review of cases that are indisputably part of the, as it were, losing contract canon. In addition to *Anglia TV*, we will give particular consideration to another controversial case, *Cullinane v British 'Rema' Manufacturing Co*,[14] and hopefully provide the means to resolve 'the considerable problems posed by those cases'.[15] It will become clear to the reader, however, that this note is in general stimulated by Ogus' thinking, and that it addresses the central issue identified by Professor Treitel in his comment on *Amann Aviation*: whether the losing contract problem involves one principle of expectation, to which the protection of reliance is always subordinate, or two principles of expectation and reliance, between which the claimant may elect.[16] McLauchlan's note on *Omak* further

[13] *Anglia TV* [1972] 1 QB 60 at 63-64, repeated in *Filobake Ltd v Rondo Ltd* [2005] All ER (D) 141 (May) at [60]; [2005] EWCA Civ 563.
[14] [1954] 1 QB 292 (*Cullinane*).
[15] *Filobake* [2005] All ER (D) 141 (May) at [59]; [2005] EWCA Civ 563.
[16] G H Treitel, 'Damages for Breach of Contract in the High Court of Australia' (1992) 108 *LQR* 226 at 229.

captures the degree of confusion, both conceptual and semantic, which still attends the consideration of this issue.

The clarification of the losing contract problem proposed here lies in the universal application of the 'second method' McLauchlan sets out, which was proposed by Mason CJ and Dawson J in *Amann Aviation*[17] and noted in what has been called Teare J's 'masterly judgment'[18] in *Omak*.[19] This method 'is simply to add the amount of wasted expenditure to the *net* profit that would have resulted from full performance',[20] and it turns on conceptualising expectation as net profits. Such a methodology has been canvassed throughout the Commonwealth discussion of the losing contract problem,[21] and so in this sense we make little claim for innovation in this article. But we nevertheless believe that the clarity of the formulation of this method is novel and of value. And we do hope additionally to show that the argument for adopting this second method, based on net profit, involves simultaneous acknowledgement of the considerations which have, in contrast, sometimes led to the conceptualisation of expectation, not as net profits, but as gross receipts. For in the end, quantification of damages requires two concepts of expectation, which should be clearly distinguished.

Assumptions

Let us consider the hypothetical case of an agreement to sell 100 tonnes of generic steel sheets for a price of £1 million, delivery to be made at the buyer's premises 6 months after

---

[17] *Amann Aviation* (1991) 174 CLR 64 at 81.
[18] *Yam Seng Pte v International Trade Corp* [2013] 1 All ER (Comm) 1321 at [186]; [2013] EWHC 111 per Leggatt J.
[19] [2011] 2 All ER (Comm) 155 at [34]; [2010] EWHC 2026 (Comm).
[20] McLauchlan, above, n 5 at 27.
[21] For example, it is 'method (1)' set out in Ogus (1973), above, n 3, p 353, the formulation of which drew on the 'penetrating analysis' (ibid, p 354) of *Cullinane* in J K Macleod, 'Damages: Reliance or Expectancy Interest?' [1970] *JBL* 19, which itself made use of elementary mathematics.

the date of the agreement. The seller anticipates that the steel will cost £900,000 to manufacture and deliver. The buyer intends to use the steel to produce corrugated roofing for retail sale.

Let us define the expectation interest as net profit. In our case the seller's net profit is the gross receipts from the sale, ie the contract price, minus the cost of manufacture and delivery, ie £1 million - £900,000 = £100,000. The buyer's net profit is the gross receipts from the retail sale of the roofing minus the cost of manufacture and distribution of the roofing, of which the contract price of the steel is part.

Let us define the reliance interest as such investment the parties may make (part-) performing their obligations which, by virtue of the breach, is wasted.[22] Whereas it is analytically the case that an expectation interest must arise in every contract (even if it later can be shown to be zero or negative), it is a purely empirical issue whether a reliance interest arises. In our case, if the buyer repudiates sufficiently early,[23] the seller's reliance interest may be zero as the breach came before the seller made any investment in performance. On the other hand (and for the present ignoring mitigation), if the seller delivers the goods and the buyer does not pay, the reliance interest is the full cost of manufacture and delivery. All forms of intermediate position may arise depending on empirical circumstances of which the time of the breach is the most important.

[22] It is debatable whether reliance so defined can extend to acts of pre-contractual reliance, and this was, of course, the issue principally addressed in *Anglia TV*. But to enter into this debate would also only distract from the issue on which this article is focused. For an exploration see Harris et al, above, n 1, pp 127-8 and M Furmston, ed, *The Law of Contract*, 4th edn, Lexis Nexis, London, 2010, para 8.67. The 5th edn of this work is in press.

[23] We put to one side the issues relating to mitigation of reliance loss by electing to affirm after repudiation associated with *White and Carter (Councils) Ltd v McGregor* [1962] AC 413, not least because the current authors hold opposed views about them.

If we let e = expectation interest, cp = cost of production (manufacture, delivery, retail distribution, etc), gr = gross receipts[24] and r = reliance interest, we may set out these concepts in simple algebraic form:

(1) e = gr – cp

(2) r ≤ cp[25]

Distinguishing the Compensation of Breaches of Contracts with Three Different Results

The profitable contract

Let us now distinguish three possible results of a contractual investment: the profitable, the break-even and the losing contract. All commercial parties enter into a contract in the belief that they will realise a profit, ie that e > 0. If that contract is breached, observance of the principle in *Robinson v Harman* will require damages to be quantified in what appear to be one of two different ways depending on whether the claimant has made an investment in reliance. If such an investment has not been made, then this is a 'wholly executory contract' for breach of which contractual damages are equal to e.[26] But, as we shall see, it would be highly misleading in this context to regard this as an award of 'pure expectation' damages. If

[24] In addition to the variants of 'gross profits' commonly employed ('gross receipts', 'gross profits', and 'gross earnings' are all used in the Law Report of the Court of Appeal proceedings in *Cullinane* [1954] 1 QB 292 at 292, 298, 299), sometimes the term 'gross returns' has been used eg *Grange v Quinn* [2013] All ER (D) 246 (Jan) at [102]; [2013] EWCA Civ 24. No doubt yet other synonyms have been employed.
[25] There are cases, particularly of construction disputes, where it is claimed that r > cp, and these are often analysed as losing contract cases. But this follows in large part from a further conceptual confusion arising from the relationship of Fuller and Perdue's restitution interest to the expectation and reliance interests, the discussion of which is often associated with the American case of *Boomer v Muir* 24 P 2d 570 (Cal App 1933). The untangling of this is a lengthy task which is not essential here but which one of the current authors has addressed elsewhere: D Campbell, 'Better Than Fuller: A Two Interests Model of Remedies for Breach of Contract' (2015) 78 *MLR* 296 at 314-22. We will therefore set claims that r > cp to one side.
[26] PS Atiyah, 'Contracts, Promises and the Law of Obligations' in *Essays on Contract*, rev edn, Clarendon Press, Oxford, 1990, p 10, p 29: '[the claimant] makes, in effect, his profit on the transaction without having to go through the transaction'.

the claimant has made an investment in reliance, then to e must be added r, and this will be called 'combined damages'.[27]

The conceptual and semantic clarification which this article attempts to make turns on showing that the distinction between pure expectation and combined damages is in an important sense illusory. If we let d = contractual damages, then the universal formula for the quantification of such damages is:

(3) d = e + r

In what appears to be an award of pure expectation damages:

(4) d = e (e > 0) + r (r = 0)

In the case of combined damages:

(5) d = e (e > 0) + r (r > 0)

One way of expressing this result is to say that there is no such thing as pure expectation damages. The point that has seemingly eluded some judges but which this note, amongst other contributions, seeks to emphasise ~~correct~~ is that in all cases the reliance interest is present and all awards of contractual damages are therefore awards of combined damages. It is just that, in some empirical circumstances, r = 0. It must be understood that the addition of zero to a quantity does not alter that quantity.

The break-even contract

In our hypothetical case, it may transpire that gr = cp so that e = 0. This is the break-even contract in which gross receipts amortise expenditure but leave no net profit. In our hypothetical case, the buyer's anticipated level of sales of roofing may not be achievable and

[27] Ogus (1973), above, n 3, pp 352, 366 uses the term 'complementary'. The point that is argued here is that, in certain circumstances, the combination of these interests is in an important sense not complementary.

the buyer is reduced to the position where the sales it does make only amortise the investment it has made in manufacturing and distributing the roofing. Equally, the seller's costs of manufacture and delivery of the steel may rise so as to equal the contract price. If the seller breaches in the first situation, or the buyer breaches in the second, contractual damages will return the claimant to the position it was in prior to the contract being agreed.

The magnitude of r being only indirectly related to the magnitude of cp, it is possible that, in the circumstances of the case, $r = 0$ and no substantial damages will arise. We may express this as:

(6) $\mathbf{d = e\ (e = 0) + r\ (r = 0) = 0}$

This represents an award of combined damages, but of a purely theoretical sort, for no claim will be made.

But if $r > 0$, even though $e = 0$, a claim for substantial damages may arise. This case, in which it appears that the claim is for reliance only, is the obverse of apparently pure expectation damages, and, by analogy it is tempting to call it an award of 'pure reliance' damages.[28] But this would again be misleading as this also is an award of combined damages, though $e = 0$. We may express this as:

(7) $\mathbf{d = e\ (e = 0) + r\ (r > 0)}$

The losing contract

In our hypothetical case, it may also transpire that $gr < cp$ so that $e < 0$. This is the losing contract, in which gross receipts would not even amortise the cost of production and so leave, not a net profit, but a net loss or negative expectation.

---

[28] N Andrews et al, *Contractual Duties*, Sweet and Maxwell, London, 2011, para 21-064.

In this case, as in the break-even contract, it is possible that, in the circumstances of the case, r = 0, and, if so, again no claim for substantial damages will arise. We may express this as:

(8) d = e (e < 0) + r (r = 0) = 0

As in the break even case, this also is a combined award of a purely theoretical sort, for no claim will be made.

But, again, if r > 0, a claim for substantial damages may be contemplated, so that:

(9) d = e (e < 0) + r (r > 0)

The losing contract problem is, of course, that an award of ‘reliance in the alternative’ would both be inconsistent with the principle in *Robinson v Harman* and raise policy issues about the (partial) ‘reversal’ of the allocation of risk under the contract that are very familiar but nonetheless very significant. Awarding ‘reliance in the alternative’ would not protect the claimant’s original expectation of profit, but it would shield the claimant from actual loss. If, in our hypothetical example, the seller’s cost of production had, because of unanticipated major increases in the cost of the steel stock from which sheets are rolled, risen to £1.1 million, then, following repudiation by the buyer, the seller’s expectation would be -£100,000. If following repudiation by the buyer when the seller had expended £100,000 on manufacture of the steel, the seller’s damages would be zero. This can be expressed as follows:

seller’s e = (gr (£1 million) – cp (£1.1 million)) = -£100,000

∴ seller’s d = (e (-£100,000) + r (£100,000)) = £0

Equally, if the buyer’s expectation of consequential profit falls because of a lower retail demand for the roofing, a similar calculation can be made in respect of a seller’s breach after the buyer has incurred reliance expenses.

Of course, all these variables can be altered, and, in particular, it should be repeated that where the magnitude of r falls within the range set by $r \leq cp$ is a merely empirical matter. But, given that these are matters of litigation rather than purely blackboard calculation, d can, of course, never fall below 0.

In sum, then, the range of possibilities in which litigation may be contemplated, all of which may be reduced to $d = e + r$, is:

(4) $d = e\ (e > 0) + r\ (r = 0)$ profitable contract when $r = 0$

(5) $d = e\ (e > 0) + r\ (r > 0)$ profitable contract when $r > 0$

(7) $d = e\ (e = 0) + r\ (r > 0)$ break-even contract when $r > 0$

(9) $d = e\ (e < 0) + r\ (r > 0)$ losing contract when $r > 0$.

How identifying this range of possibilities, and the universality of $d = e + r$, helps us to analyse the losing contract problem is best discussed by turning directly to some of the decided cases of the losing contract canon.

4. Application to Decided Break-even and Losing Contract Cases

The result of the argument so far is that all awards of contract damages should be seen as combined awards of expectation and reliance, bearing in mind that expectation is defined as net profit and that the addition of zero to a quantity does not alter that quantity. The universal formula for contract damages is, to repeat:

(3) $d = e + r$

In light of this, the statement by Lord Denning quoted previously[29] can be seen to be misleading in two ways, though we shall defer discussion of the second. Saying that the claimant 'can claim in the alternative the expenditure which has been thrown away, that is,

---

[29] *Anglia TV* [1972] 1 QB 60 at 63-64.

wasted, by reason of the breach' is, with respect, wrong. There is no possibility of claiming 'in the alternative'. On the analysis put forward here, the claimant in *Anglia TV* sought combined damages, but $e = 0$. It will be recalled that, after the defendant in *Anglia TV* repudiated an obligation to act in a tv play, the claimant terminated and sought damages. Faced with difficulties of uncertainty in quantification, the claimant did not claim for 'lost profits' but confined itself to 'wasted expenditure'.[30] The claimant, unable to prove 'lost profits', was understood by Lord Denning not to claim expectation at all but, 'in the alternative', reliance. However, just as the claimant did not seek to claim e, crucially neither did the defendant seek to show that $e < 0$, ie that the claimant's expectation was negative. This therefore was, on the pleadings, actually not a case of claiming reliance in the alternative but a break-even case in which:

(7) $d = e\ (e = 0) + r\ (r > 0)$

This appears to be pure reliance damages, but this is exactly what it is not. As was made clear in *CCC Films (London) Ltd v Impact Quadrant Films Ltd*,[31] in *Anglia TV* it was 'assumed that the plaintiffs would, had they made the film, at least have recouped their expenditure'. The confusion arising from *Anglia TV* stems from the fact that Lord Denning did not realise that he was making this assumption.

That this assumption was essential to the conclusion in *Anglia TV* was shown in *C and P Haulage v Middleton*,[32] in which a claimant who sought damages for wasted expenditures was confined to nominal damages because *C and P Haulage* was treated as a losing contract case, an instance of:

(9) $d = e\ (e < 0) + r\ (r > 0)$

---

[30] [1972] 1 QB 60 at 63. See further *C and P Haulage v Middleton* [1983] 1 WLR 1461 at 1465-1466.
[31] [1985] 1 QB 16 at 38 (*CCC Films*). See further *Amman Aviation* (1991) 174 CLR 64 at 86.
[32] [1983] 1 WLR 1461 (*C and P Haulage*).

As it happens, *C and P Haulage* was *per incuriam* because it was on the reported facts wrong to treat it as a losing contract case.[33] But, putting this to one side, to hold that the negative expectation should have had an influence on the reliance award was correct in principle. And this makes it clear why it is essential to see that reliance played an indispensable, if unfortunately silent, role in *Anglia TV*. The assumption that e = 0 allowed r to be awarded. This is entirely correct. What was wrong was that the assumption that e = 0 was left unclear. It should have been a finding, or at least an acknowledged assumption, and explaining this is the contribution of *CCC Films*, supported by *Amann Aviation* in particular.[34]

As *C and P Haulage* was not on the reported facts shown to be a losing contract, even if we try to build on its correct statement of principle we must be left with the live question whether a negative expectation, whatever its size, completely extinguishes a positive reliance claim or whether it merely limits the reliance award. If e = **-**£100,000, does this mean that nothing will be awarded if r = £200,000, or will £100,000 be awarded?[35] On the basis of *Robinson v Harman*, logically and in terms of policy, the latter alternative should be preferred; indeed, there is no logical basis for the former. There may be practical issues of quantification which stand in the way of this alternative. This article seeks merely to clarify the conceptual issues and we take no position on this question.

---

[33] R D Taylor, '*C and P Haulage v Middleton* (CA)' (1984) 18 *Law Teacher* 217 at 218.

[34] *Yam Seng* has, of course principally attracted attention from contract lawyers because of its recognition of an implied duty of good faith (eg D Campbell, 'Good Faith and the Ubiquity of the "Relational" Contract' (2014) 77 *MLR* 475). But the damages position was analysed by Leggatt J in a similar and interesting way as in *CCC Films*. In *Yam Seng* [2013] 1 All ER (Comm) 1321 at [191]; [2013] EWHC 111, Leggatt J said that 'ITC has not attempted to discharge the burden of showing what financial return Yam Seng would have made if ITC had not been in breach of contract'. At [196] he made explicit the assumption that some sales had taken place but was unable to quantify them.

[35] Despite the considered *dicta* of Berger J, the important Canadian case of *Bowlay Logging Ltd v Domtar Ltd* (1978) 87 DLR (3d) 325 (affd (1982) 135 DLR (3d) 179), which did involve a losing contract, does not help as much as it might in this respect as, by curious coincidence, the expectation loss seems to have more or less matched the reliance claim: ibid, at [48].

5. Mitigation Taken Into Account in Break-even and Losing Contract Cases

When no opportunity to mitigate arises, the analysis so far will be able to account for the foundation of quantification in all contracts, whether profitable, break-even or losing. But when such an opportunity does arise in break-even or losing contract cases, it gives rise to issues which merit discussion here. Our hypothetical case, turning on the sale of generic steel, is one which particularly invites mitigation, for when the goods are generic it is highly likely that there is a market in them; in the most practically important sense this is what the goods being generic means. Using the facts of that case, we will consider the positions of a claimant seller and a claimant buyer in turn.

Following buyer's repudiation or wrongful rejection of deliverable steel, or steel which may be put into a deliverable state at a reasonable cost assessed in the context of mitigation, the possibility of resale arises, and if the resale price is lower than the contract price, the seller will be able to claim the difference as market damages. Regardless of whether the contract is a profitable, a break-even or a losing one, mitigation always, as it were, displaces the original expectation calculated as gr – cp = np and substitutes for this market damages.[36] But whereas in a profitable contract this would effectively restore the seller's original expectation, it would alter it in a break-even or a losing contract. In a profitable contract, the mitigating seller resells at a price which, after payment of damages, is intended to match the original price.[37] In a break-even or a losing contract, the payment of substantial market

[36] The justification for this substitution, which, together with the corollary response to seller's breach, is the paradigm of remedies for breach of contract is set out in D Campbell, 'The Relational Constitution of Remedy: Co-operation as the Implicit Second Principle of Remedies for Breach of Contract' (2005) 11 *Texas Wesleyan L Rev* 455.

[37] The shortcomings of the law of market damages which can lead to this intention not being realised are analysed in D Campbell, 'Market Damages and the Invisible Hand', in L DiMatteo and M Hogg, eds,

damages to a mitigating seller is a payment which will place the seller in a superior position to the one in which it would have been placed by performance, albeit that one speculates that the difference may well of little significance and the substantial market damages largely theoretical.

Following a seller's repudiation or failure to deliver conforming goods when the contract is profitable for the buyer, the buyer will have to find a substitute for the steel, which we remind the reader is generic, and manufacture the roofing. If it does not do this in these circumstances, it cannot claim the consequential loss following from failure to sell the roofing. Mitigation means that the buyer's damages are shifted from the consequential loss, which is avoided, to market damages, if any, representing the difference by which the market price exceeds the contract price. The buyer's expectation is protected, but again in a way only remotely related – it perhaps is even better to say is unrelated - to its original expectation, which plays no part in quantification.

It is possible that in a break-even or losing contract, the award of substantial market damages to the buyer could, as with the seller, improve the buyer's position by comparison to the original expectation of zero or less than zero, though again one speculates this may well be largely theoretical and of little significance. Nevertheless, as this improvement of the positions of the seller and the buyer would defeat the principle in *Robinson v Harman*, the question arises whether it is wise to allow such an outcome, and here we return to *Omak*.

In general, the understanding of the relationship between original expectation and expectation protected through mitigation is by no means entirely satisfactory. In *Omak*, the charterer unaccountably repudiated a charterparty when freight rates were rising. This allowed the owners to earn more over the remaining term of the charter than they would have

Comparative Contract Law: British and American Perspectives, Oxford University Press, Oxford, forthcoming 2015.

earned had they performed their original obligation. The owner nevertheless claimed reliance losses incurred in making modifications to their vessel required for the specific purposes of the charterparty which were of no residual value. As, it would seem, the contract was agreed on the default understanding that $d = e + r$, and, whilst $e = 0$, $r > 0$, the correct outcome seems simple enough to us in terms of the issues considered here,[38] but reliance damages were not awarded.

The problem in *Omak* was caused by the conduct of the charterers. In the circumstances of rising freight, the charterer wishing to be released from its obligations could and should, rather than breaching, have negotiated a release at no cost, or even have charged for releasing the owner. By not doing so, it seems to have acted irrationally and thereby to have created a situation which the relevant rules find it difficult to handle. *Omak* was not in fact a case which turned on the losing contract issue nor, in our opinion, on the relationship between the contractual interests generated by the contract between the parties at all. Rather, the principal confusion in the judgment stemmed from an inability, traceable to the *British Westinghouse* case[39] but gravely exacerbated by *The Golden Victory*,[40] to coherently relate to the original expectation the effect of steps taken after breach. This in the end is a question of whether the parties' liabilities should be assessed according to what they could reasonably know at the time of their agreement or according to knowledge only the court could gain subsequently. To the authors of this article, who wish to, so far as possible, give effect to the intention of the parties, this seems to be a question hardly worth asking. But to courts which seem

[38] And seems to have been similarly clear to the arbitrators, although their reliance on *C and P Haulage* inevitably raises a question mark against their finding: *Omak* [2011] 2 All ER (Comm) 155 at [8]; [2010] EWHC 2026 (Comm).
[39] *British Westinghouse Electric and Manufacturing Co Ltd v Underground Electric Railways Co of London Ltd* [1912] AC 673.
[40] *Golden Strait Corporation v Nippon Yusen Kubishka Kaisha* [2007] 2 AC 353; [2007] UKHL 12.

incapable of resisting the temptation to do justice[41] it evidently is one which gives rise to serious difficulties. As these difficulties are irrelevant to the point we wish to clarify in this article, we put them to one side.

6. Conclusion: One Principle *and* Two

Formatted: Font: Italic

In this article we have sought by the use of elementary mathematics to clarify the analysis of the losing contract problem associated with *Anglia TV v Reed*. The claim that is the basis of the clarification is that, in all cases, regardless of whether the contract is profitable, break-even or losing and regardless of whether the reliance claim is ≥ 0, contractual damages should be quantified as the sum of the compensatory damages necessary to protect the expectation interest and the compensatory damages necessary to protect the reliance interest, that is:

(3) d = e + r

It must, as we have said before, be borne in mind that expectation is defined as net profit and that the addition of zero to a quantity does not alter that quantity.

Even if this clarification is found to be of value, it hardly resolves all the problems of the quantification of damages on the basis of the three interests analysis. One problem remains of particular significance to us here. It is obvious – and Treitel's comment on *Amaan Aviation* makes it particularly so – that in the cases in the losing contract canon 'expectation' has been used in (at least) two very different ways. One of these ways has been to describe the goal set out in *Robinson v Harman*, which we have seen Fuller and Perdue describe as: 'to put the [claimant] in as good a position as he would have occupied had the defendant

[41] N Andrews, 'Civil Disgorgement of Wrongdoers' Gains: The Temptation to do Justice', in W R Cornish et al, eds, *Restitution: Past, Present and Future*, Hart, Oxford, 1998, ch. 10.

performed his promise'.[42] This is what we will call the 'overall' concept of expectation. It is quite different to the net profit conception, upon the use of which in quantification we have so far insisted. But whereas correct quantification requires the use of the net profit conception, it has been argued that damages are always the sum of net profit and reliance and that the goal of quantification therefore should never be understood as ending with expectation in the sense of net profit. That goal, the *Robinson v Harman* goal, is, indeed, to lead to the overall concept of expectation, and it is in this sense that McLauchlan is right to say that the reliance interest is redundant.[43]

It can now be seen that the second misleading aspect of Lord Denning's judgment in *Anglia TV* was that, when he stated that a claimant could 'either claim for loss of profits; or for his wasted expenditure', he did not sufficiently strenuously distinguish between net profits and what we have termed gross receipts. Citing *Cullinane*,[44] Lord Denning was at pains to insist that a claimant cannot claim both its 'lost profits' and 'expenditure which has been … wasted'. [45] But, having the overall concept of expectation in mind, Lord Denning did not realise that this conception, based on the gross receipts expected at the time of the agreement, always involves, as cost of production, expenditures which can be the basis of a claim for 'wasted expenditure'. And it is impossible simply to separate out, and then sum, expectation and reliance in a coherent way if we try to work with a conception of expectation as gross receipts, for that conception confusingly makes reliance an integral part of expectation.[46] We must identify expectation as net profit in order to do effect this separation.

---

[42] Fuller and Perdue, above, n 8 at 54.
[43] McLauchlan, above, n 5. See also D McLauchlan, 'Reliance Damages for Breach of Contract' [2007] *NZLR* 417.
[44] [1954] 1 QB 292.
[45] *Anglia TV* [1972] 1 QB 60 at 64.
[46] It is possible, working with gross receipts, to correctly quantify contractual damages, but it involves the use of a concept of 'loss avoided' which plays no coherent part in the Commonwealth cases on the losing contract problem and, though it stresses the importance of mitigation, does not easily map on to

Let us apply our method to *Cullinane* which, largely as a result of its citation by Lord Denning, is the modern source of the difficulties addressed in this article. We believe our method clarifies the conceptual issues in this persistently confusing case, indeed shows them to be quite simple, though no method can properly clarify the outcome in the case on the basis of the reported facts, which remain ultimately obscure.

Cullinane was not a losing contract case, an argument by the defendant that it was being rejected.[47] Difficulties arose, however, over the combination of expectation and reliance in the quantification of damages for beach even of a contract found to be profitable. The case arose from the commercially very significant failure of a clay pulverising plant sold by the defendant to work at the rate it was found that the defendant had warranted.[48] Over what, after dispute, was found to be the appropriate period for quantification,[49] and also after various deductions and adjustments and the addition of interest, the official referee awarded total damages of £16,813 7s 2d (approximately £425,000 in 2015).[50] This total included a claim for 'loss of profit' of £8,913 1s, and to this was added a capital investment of £7,370 1s 5d, which itself was the sum of £3,289 spent in buying the pulverisor, £2,559 1s 5d spent on other plant to house it, and £1,522 spent on other ancillary plant; all wasted because of the breach. In justification of decision to confine the plaintiff to £8,913 1s, Evershed MR said:[51]

> I think that the plaintiff could choose to claim on the basis that he had wasted capital, and that he ought to be put in the position he would have been in if he had never bought this machine; or, alternatively, he was entitled to say: 'I have got the machine: what I am claiming is the loss I have suffered because its performance falls short of that which was warranted; therefore I have not made profitable sales

the decided law on mitigation. A subsidiary source of confusion in *Omak* was the definition of a straightforward contractual damages claim in a way that made uncomprehending reference to loss avoided: *Omak* [2011] 2 All ER (Comm) 155) at [15]; [2010] EWHC 2026 (Comm).

47 *Cullinane* [1954] 1 QB 292 at 304.

48 [1954] 1 QB 292 at 299-300.

49 [1954] 1 QB 292 at 311-12.

50 The following figures are taken from the statement of the 'particulars of damage' as adjusted by the official referee in ibid, at 293-5. In addition to the major adjustment on which we shall focus, the damages were further adjusted in a minor way which we shall ignore by the Court of Appeal: [1954] 1 QB 292 at 307, 309, 312.

51 [1954] 1 QB 292 at 306-7, Jenkins LJ concurring ([1954] 1 QB 292 at 312).

> which I would have made, and I claim, accordingly, the loss of such profits'. The second alternative being the larger, he was entitled to choose that; but, in my judgment, he should be limited to it. By stating that his claim for lost profit was limited to three years, he was not, in my judgment, then entitled to claim … both for loss of capital *and* for loss of profit … The result will be that from the figures which I have mentioned the first three items [of £3,289 + £2,559 1s 5d + £1,522 = £7,370 1s 5d] ought to be omitted. Otherwise, I think that the plaintiff is receiving damages, in effect, twice over. The total amount of damages proved which the plaintiff is entitled to recover consist of the sum of £8,913 1s.

As the (£3,289 + £2,559 1s 5d + £1,522 =) £7,370 1s 5d indisputably is a reliance claim, Evershed MR's reduction of the total damages to (£16,813 7s 2d - £7,370 1s 5d ≈) £8,913 1s[52] would be justified if 'loss of profit' represented gross receipts. The claimant always intends gross receipts to amortise the cost of production as well as generate a net profit, therefore the claimant always enters into the contract in the belief that ~~r ≤ cp~~ cp will be included in gr. As r ≤ cp, ie as r when it arises is all or part of cp, a~~A~~dding a claim for reliance to a claim based on gross receipts therefore would necessarily have led to 'double recovery' of reliance. It is not, with respect, entirely possible to understand what the majority had in mind, but it seems that they equated any claim for 'loss of profit' as a claim for gross receipts. In contrast, Morris LJ dissenting identified 'loss of profit' as a claim for net profit, and, of course, if this is so, then *Cullinane* is an in principle simple claim for d = e + r and therefore £16,813 7s 2d ≈ ~~. (~~£8,913 1 s + £7,370 1s 5d ~~≈) £16,813 7s 2d~~ should have been awarded. The merits of the competing arguments whether 'loss of profit' in the case was closer to gross receipts or net profit, which we submit are not entirely understandable on the ultimately unclear reported facts, though Morris LJ's views are to be preferred, [53] can be put to one side as, like the existence of the Loch Ness monster, a puzzle the answer to which it

[52] The sum of £8,913 1 s and £7,370 1s 5d is not, of course, £16,813 7s 2d. The referee's award included interest of £1,608 4s 9d and a deduction of £1,078 for the unpaid balance of the price of pulveriser. The £16,813 7s 2d figure is arrived at in this way: (£8,913 1 s + £7,370 1s 5d + £1,608 4s 9d =) £17,891 7s 2d - £1,078 = £16,813 7s 2d.
[53] Ogus (1973), above, n 3, pp352-4 and Harris et al, above, n 1, pp 130-1.

would be nice to know,[54] but which we can manage to get along without knowing.[55] A proper understanding of *Cullinane* does, however, show that, in principle, for the combination of e + r to produce the correct quantification, it is necessary that e = np.

But the fundamental reason that *Cullinane* exerted what seems such an unfortunate influence on *Anglia TV*, and that the case remains of significance, is that, even accepting d = e + r as a universal formula, the difficult point remains that we cannot entirely do away with something akin to seeing expectation as gross receipts, for we must fundamentally be guided by the overall concept of expectation if we are to observe the principle in *Robinson v Harman*. e + r is the correct methodology, but this methodology is never intended to lead to e as the result of quantification but to the overall concept of expectation.[56] Coherent quantification of the overall concept always involves, using the terms set out here, the use of expectation as net profit combined with reliance, ie it involves the use of a second, quite different, sense of expectation in order to reach the overall concept of expectation.

It is fruitless to say that we should seek to eliminate this use of two senses of expectation as both serve an essential purpose. It is therefore necessary to rename at least one of them. We therefore submit that the 'expectation interest' should continue to be used for the net profit concept of expectation and that the overall concept of expectation should be called,

[54] As the miracles that have been wrought by 'legal archaeological' scholarship after the fashion of the late Brian Simpson even now include making *Bell v Lever Bros Ltd* [1932] AC 161 comprehensible, one might hold out some hope of an eventual answer: C Macmillan, 'How Temptation Led to Mistake: An Explanation of *Bell v Lever Bros Ltd*' (2003) 119 *LQR* 625.
[55] Very similar facts to *Cullinane* arose in *TC Industrial Plant Pty Ltd v Robert's Queensland Pty Ltd* (1963) 180 CLR 130, the issue being the possible combination of claims for lost profits of A£12,000 and wasted expenditure of A£15,889 15s 6d which made up a total award of A£27,889 15s 6d (approximately A$851,500 or UK£443,605 in 2015). In what seems to us to be an excellent account, including some elementary mathematics, of the reasoning of the majority and the dissent in *Cullinane*, essentially the interpretation set out in this paper was advanced: (1963) 180 CLR 130 at 138-41. As the issue then was exactly what was meant by lost profits, and as this was no clearer on the evidence presented to it than it had been in the report of *Cullinane*, the High Court wisely remitted the case for reassessment of this issue, the results of which are, on the basis of very limited researches, unknown to us.
[56] Of course, e seems to be the result in the case of the apparently pure expectation award, but only, we repeat, because d = e (> 0) + r (= 0).

bathetically enough, the 'overall expectation interest'. If we denote the overall expectation interest by E, then E may be substituted for d in (3) d = e + r, and so:

(10) d = E = e + r