

# CONSEQUENTIAL DAMAGES IN CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS AND THE LEGACY OF *HADLEY*

ARTHUR G. MURPHEY, JR.\*

## I. INTRODUCTION

On January 1, 1988, an unusual treaty came into effect in the United States—the United Nations Convention on Contracts for the International Sale of Goods (C.I.S.G.).<sup>1</sup> The C.I.S.G. is unusual because it means that some, although not all, contracts for the international sale of goods entered into by U.S. buyers and sellers will be governed by conventional international law under one treaty.<sup>2</sup>

The C.I.S.G. will present numerous problems in interpretation. United States judges deciding a case governed by the C.I.S.G. will have to deal with the “bare bones”—the interpretation of articles of the C.I.S.G. without the benefit of prior U.S. cases to guide them. Thus, U.S. judges must be aware of how their decisions will meet the C.I.S.G.’s goal of “harmonization.” That is, under the C.I.S.G., cases with similar fact patterns should yield similar results, even when the cases are decided by the courts of different countries.<sup>3</sup> Yet, unlike the U.S. common law

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\* Professor of Law, University of Arkansas at Little Rock School of Law. LL.M. 1962, Yale; J.D. 1953, University of Mississippi; A.B. 1951, University of North Carolina. I thank Professors Peter Linzer, John A. Spanogle, Jr., and Bradford Stone for their comments and suggestions on the draft of this paper.

1. United Nations Convention on Contracts for the International Sale of Goods, Apr. 11, 1980, 19 I.L.M. 668, 671 (1980) (entered into force Jan. 1, 1988), *reprinted in* Public Notice, 52 Fed. Reg. 6262-80 (1987) [hereinafter C.I.S.G.]. There are six official language versions of the C.I.S.G.: Arabic, Chinese, English, French, Russian, and Spanish. See *Final Act of the United Nations Conference on Contracts for the International Sale of Goods*, U.N. Doc. A/Conf. 97/18 (1980). As of December 22, 1989, the parties to the C.I.S.G. were Argentina, Australia, Austria, Byelorussian SSR, Denmark, Federal Republic of Germany, Egypt, Finland, France, German Democratic Republic, Hungary, Italy, Lesotho, Mexico, Norway, People’s Republic of China, Sweden, Syria, United States, Yugoslavia, and Zambia. Current information on parties to the Convention may be obtained from the United Nations Treaty Section of the Office of Legal Affairs (tel.: (212) 754-7958/5048).

2. For a discussion of those governed and not governed, see *infra* notes 14-18 and accompanying text.

3. C.I.S.G., *supra* note 1 art. 7. The C.I.S.G. provides “[i]n the interpretation of

system, civil law countries do not use cases as precedent. A U.S. judge may need to speculate about what technique of interpretation a foreign judge will adopt. This article discusses some of the matters that might be considered in interpreting the C.I.S.G. articles. The focus is on a single article of the C.I.S.G. which may present special problems in interpretation—the article which governs the recovery of consequential damages.

Many prudent international buyers and sellers will have contracts containing a provision on liability for consequential damages. This article examines those cases in which a contract is silent on the issue of consequential damages. Such cases will require a court to determine whether, and to what extent, consequential damages are to be awarded.

The court's determination will differ greatly from the task of measuring damages by some mathematical formula, as when the court determines the damages should be based on the difference between the market price and the contract price. Since there is no mathematical rule for assessing consequential damages, judges must navigate across a poorly-charted plain. The calculation of consequential damages requires interpreting such terms as "foreseeable" and "possible"—words that may reflect the values of the judge.<sup>4</sup>

In calculating the measure of consequential damages, a judge looking to the C.I.S.G. may ask several questions. First, to what extent should the words used in the C.I.S.G. be compared with those used in other U.S. laws or rules concerning consequential damages? Second, what principles are served by the use of those words in U.S. case law? Third, what is the significance of the words in the C.I.S.G. for peoples of other nations who also will be bound by its terms? Fourth, what principles do those nations seek in their rules on consequential damages?

This article examines the landmark British case concerning the recovery of consequential damages—*Hadley v. Baxendale*<sup>5</sup>—

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this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade." *Id.*

4. "Courts and arbitral tribunals will find it difficult to restrain parties of different legal systems from submitting interpretations of the Convention's provisions highly influenced by those systems. It can further be questioned whether courts that belong to those different legal systems are not in any event predisposed to adopt such substantially diverse interpretations." Thieffry, *Sale of Goods Between French and U.S. Merchants: Choice of Law Considerations Under the U.N. Convention on Contracts for the International Sale of Goods*, 22 INT'L LAW. 1017, 1021 (1988).

5. *Hadley v. Baxendale*, 156 Eng. Rep. 145 (Ex. 1854). The case has been one of

because the author believes that the decision will exert some influence on judges' interpretation on the recovery of consequential damages<sup>6</sup> under the C.I.S.G. This article examines some present trends in recovery,<sup>7</sup> followed by comments on the desirability of extending protection to the victim of a breach of contract. The article then examines *Hadley*, its principles, and its "rule." The article also explores the critical phrases of Article 74 of the C.I.S.G., which is concerned with consequential damages. Finally, some ideas from the legal systems of other countries are applied to the interpretation problems posed by Article 74. Because some U.S. international sales cases not governed by the C.I.S.G. will instead be governed by the Uniform Commercial Code (UCC), this article examines relevant sections of that code. Since the Restatement (Second) of Contracts (Restatement) is influential, this article considers relevant Restatement sections as well.

*Hadley* is especially important because of three recent events. Two events concern alterations of the rule of the case that had been considered by many as discarded long ago: one concerning the time that the breaching party should foresee the loss and the other concerning the infamous tacit agreement rule. The third event represents divergence between the United States and British versions of the rule. Because of these events, U.S. judges should try to divorce themselves from the influence of *Hadley* as much as possible; its rules are not the same as those under the consequential damages article of the C.I.S.G.

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the more important cases for students in American law schools. R. DANZIG, *THE CAPABILITY PROBLEM IN CONTRACT LAW* 76 (1978) (noting the "exceptional pedagogical centrality" of *Hadley*); J. WHITE AND R. SUMMERS, *UNIFORM COMMERCIAL CODE* 443 (3d ed. 1988). Immortality—or at least a promising future—has been ascribed to it. "*Hadley v. Baxendale* is still, and presumably always will be, a fixed star in the jurisprudential firmament." G. GILMORE, *THE DEATH OF CONTRACT* 83 (1974). But Gilmore had earlier described it, in his own inimitable style, as "an essentially uninteresting case, decided in a not very good opinion by a judge otherwise unknown to fame." *Id.* at 49. All but a very few judges in state and federal courts in the United States probably were exposed to the case when they were law students. Many may even remember the case by name, along with the proposition for which it is said to stand.

6. It should be noted that the term consequential damages has sometimes been used to refer to damages that cannot be recovered. Bulow, *Consequential Damages and the Duty to Mitigate in New York Maritime Arbitrations*, 1984 LLOYD'S MAR. & COM. L. Q. 622, 624. "The phrase 'consequential damages' has, unfortunately, been given a somewhat narrow and pejorative meaning in maritime arbitrations. Maritime arbitrators use it to mean that the damages claimed are too remote and not recoverable." *Id.* That meaning is not adopted here.

7. This is to acknowledge that others may have different data or even interpret the data given here differently. The material here reflects the author's conclusions.

## II. AN INTRODUCTION TO THE C.I.S.G. AND ARTICLE 74

The C.I.S.G. is just one step in a movement toward the international unification of private law.<sup>8</sup> Work on a uniform law for the international sale of goods began fifty years ago by the International Institute for the Unification of Private Law (UNIDROIT).<sup>9</sup> UNIDROIT drafted two treaties known as the 1964 Hague Conventions: the Convention Relating to a Uniform Law on the Formation of Contracts for the International Sale of Goods (ULF),<sup>10</sup> and the Convention Relating to a Uniform Law on the International Sale of Goods (ULIS).<sup>11</sup> The United States was never a party to either the ULF or the ULIS. In 1968, the United Nations established the United Nations Commission on International Trade Law (UNCITRAL), which began preparing rules for the sale of goods. Representatives of this group, which included U.S. Delegates, drew up the C.I.S.G., combining rules both for the formation of contracts<sup>12</sup> and for the sale of goods.<sup>13</sup>

The general rule set out in Article 1 of the C.I.S.G., as adopted by the United States, is that the C.I.S.G. applies to contracts between parties in which one's place of business is in the United

8. The latest step is the Convention on International Bills of Exchange and International Promissory Notes, G.A. Res. 43/165, *reprinted in* 28 I.L.M. 170 (1989). It will be open for signature at the Headquarters of the United Nations until June 30, 1990. Among those involved in the work on this treaty is Professor John A. Spanogle, Jr., of the George Washington University National Law Center.

Another such treaty is the 1980 Convention on The Civil Aspects of International Child Abduction. S. Doc. No. 99-11, *reprinted in* 51 Fed. Reg. 10,494-516 (1986) (including official English language version of the Convention text). For a report on work in this area, see Pfund, *International Unification of Private Law: A Report on U.S. Participation—1987-88*, 22 INT'L LAW. 1157 (1988).

9. J. HONNOLD, UNIFORM LAW FOR INTERNATIONAL SALES UNDER THE 1980 UNITED NATIONS CONVENTION § 5, at 49 (1982). UNIDROIT suspended its work during World War II and resumed its drafting in the 1950's. *Id.*

10. Convention Relating to a Uniform Law on the Formation of Contracts for the International Sale of Goods, July 1, 1964, 834 U.N.T.S. 169.

11. Convention Relating to a Uniform Law on the International Sale of Goods, July 1, 1964, 834 U.N.T.S. 107.

12. C.I.S.G., *supra* note 1, pt. II, arts. 14-24.

13. C.I.S.G., *supra* note 1, pt. III, arts. 25-88. One of the U.S. representatives, Professor John Honnold, authored a major work on the C.I.S.G., J. HONNOLD, *supra* note 9, and has recently completed another book on the history and background of the C.I.S.G. J. HONNOLD, DOCUMENTARY HISTORY OF THE UNIFORM LAW FOR INTERNATIONAL SALES: THE STUDIES, DELIBERATIONS, AND DECISIONS THAT LED TO THE 1980 UNITED NATIONS CONVENTION WITH INTRODUCTIONS AND EXPLANATIONS (1989). Professor Allan Farnsworth, another U.S. representative, has written an article addressing damages under the C.I.S.G. Farnsworth, *Damages and Specific Relief*, 27 AM. J. COMP. L. 247 (1979). Those wishing to read further about the C.I.S.G. will find sources in a recent and extensive bibliography. Winship, *A Bibliography of Commentaries on the United Nations International Sales Convention*, 21 INT'L LAW. 585 (1987).

States and the other's place of business is in another country which has ratified the C.I.S.G.<sup>14</sup> Yet, except to the extent that adoption is forbidden by some mandatory rule of a relevant jurisdiction (such as where the law of a party's place of business governs the case), parties not otherwise bound by the C.I.S.G. may adopt certain articles, including the article on consequential damages, as the governing law. The parties could, in essence, incorporate by reference articles of the C.I.S.G. without writing them into the contract. A court also could apply the C.I.S.G. in a dispute between a U.S. citizen and a party from a country which did not ratify the C.I.S.G. This scenario might arise if the case were tried in a third country which had adopted a version of Article 1 different from that adopted by the United States.<sup>15</sup>

The C.I.S.G. would not apply if parties otherwise bound agree not to be bound by the C.I.S.G. Since the C.I.S.G. now prevails over state laws such as the UCC under the supremacy clause of the U.S. Constitution,<sup>16</sup> the parties should carefully draft clauses to opt out of coverage for specified transactions.<sup>17</sup> In addition, if

14. C.I.S.G., *supra* note 1, art. 1. Article 1 provides:

(1) This Convention applies to contracts of sale of goods between parties whose places of business are in different States:

(a) when the States are Contracting States; or

(b) when the rules of private international law lead to the application of the law of a Contracting State.

(2) The fact that the parties have their places of business in different States is to be disregarded whenever this fact does not appear either from the contract or from any dealings between, or from information disclosed by, the parties at any time before or at the conclusion of the contract.

(3) Neither the nationality of the parties nor the civil or commercial character of the parties or of the contract is to be taken into consideration in determining the application of this Convention.

*Id.* Article 95 provides that "[a]ny State may declare at the time of the deposit of its instrument of ratification, acceptance, approval or accession that it will not be bound by subparagraph (1)(b) of article 1 of this Convention." *Id.* art. 95.

The United States chose not to be bound by article 1(1)(b). Therefore, U.S. courts will not apply the C.I.S.G. to suits between parties if one has its place of business in a country not a party to the treaty.

15. More specifically, if that country adopted subsection (1)(b), the rules of private international law of that country could lead to the application of the law of the Treaty. For further discussion on this point, see Thieffry, *supra* note 4, at 1018-19.

Note also that the United States' reservation excluding (1)(b) could affect an attempt to opt into the whole Convention. See R. FOLSOM, M. GORDON, AND J. SPANOGLE, INTERNATIONAL BUSINESS TRANSACTIONS IN A NUTSHELL 70-71 (3d ed. 1988). This author limits his conclusions to attempts to incorporate certain performance terms only.

16. U.S. CONST. art. VI.

17. Article 6 provides that "[t]he parties may exclude the application of this Convention or, subject to article 12, derogate from or vary the effect of any of its provisions." C.I.S.G., *supra* note 1, art. 6.

Article 12, referenced in Article 6, addresses the effect of several provisions of the

the dispute goes into arbitration, an arbitration panel might decide not to apply the C.I.S.G.<sup>18</sup> Parties to sale of goods contracts which are not governed by the C.I.S.G.—those whose contract does not qualify under Article 1 or parties who agree not to be bound by the C.I.S.G.—may find themselves instead bound by contract and sales laws of the United States, usually the UCC, if not the laws of some other country.

The pertinent C.I.S.G. article, Article 74, provides:

Damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach. Such damages may not exceed the loss which the party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract, in light of the facts and matters of which he then knew or ought to have known, as a possible consequence of the breach of contract.

Article 74 comes into play following a breach by either the seller<sup>19</sup> or the buyer<sup>20</sup> and is "a general rule for the calculation of damages for every loss suffered as a consequence of a breach of contract."<sup>21</sup> Article 74 may also be invoked under the two articles which follow it regarding particular cases in which the contract has been avoided. Article 75 applies when the buyer, after

Convention which allow contracts to be made in a form other than in writing. Several countries object to those provisions, and Article 12 allows a country to declare the provisions inapplicable in their jurisdictions. *Id.* art. 12. The effect of these articles is that if a nation forbids oral contracts, the parties cannot agree that an oral contract will bind them.

For caution on "opting out" of the Convention, see R. FOLSOM, M. GORDON, AND J. SPANOGLA, *supra* note 15, at 70 (warning against a simple statement that the contract "shall be governed by New York law," since a court could hold that the treaty is New York International Sales Law).

18. Thieffry, *supra* note 4, at 1019. "Yet, it should be remembered that the arbitrators have some discretion to determine the rules of law that they will use. The mere fact that a sale of goods occurred between two entities situated in France and in the United States, therefore, will not automatically lead the arbitrators, unlike the Contracting States' courts, to apply the Convention." *Id.*

19. See C.I.S.G., *supra* note 1, art. 45(1) (stating that "[i]f the seller fails to perform any of his obligations under the contract or this Convention, the buyer may . . . claim damages as provided in articles 74 to 77"). For a discussion of Article 77, see *infra* note 236 and accompanying text.

20. See C.I.S.G., *supra* note 1, art. 61 (stating that "[i]f the buyer fails to perform any of his obligations under the contract or this Convention, the seller may . . . claim damages as provided in articles 74 to 77").

21. Knapp, *Damages in General*, in C. BIANCA AND M. BONNELL, COMMENTARY ON THE INTERNATIONAL SALES LAW, THE 1980 VIENNA SALES CONVENTION 538, 539 (1987). For a general discussion of Article 74, see *id.* at 538-48; see also J. HONNOLD, *supra* note 9, § 403, at 408 (stating that "to state basic principles to govern compensation for breach of contract . . . is the role of the present article").

the seller's breach, has bought goods in replacement of those that were the subject of the contract, or when the seller, after the buyer's breach, has sold the contract goods.<sup>22</sup> Article 75 is thus similar to the UCC rules on contract-cover<sup>23</sup> and contract-resale.<sup>24</sup> Article 76 measures damages by the current price<sup>25</sup> and is similar to the UCC contract-market rules.<sup>26</sup> Both Articles 75 and 76 allow for the recovery of consequential damages under Article 74. In addition, Article 74 applies when the contract has not been avoided, and thus will apply to cases of accepted but non-conforming goods, breach of warranty, and accepted goods not properly delivered, such as goods delivered late.

### III. SOME THOUGHTS ON INTERPRETATION

Because the C.I.S.G. has become U.S. law, a judge must interpret the C.I.S.G. consistent with both U.S. law and "harmonized" international law. A judge might look to the plain meaning or the legislative history of the C.I.S.G., or consider the goal of U.S. contract law as reflected in contract damages law, particularly as reflected in the law of consequential damages. The goal of contract law is to protect the expectations of the parties; but the goal

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22. C.I.S.G., *supra* note 1, art. 75. Article 75 provides:

If the contract is avoided and if, in a reasonable manner and within a reasonable time after avoidance, the buyer has bought goods in replacement or the seller has resold the goods, the party claiming damages may recover the difference between the contract price and the price in the substitute transaction as well as any further damages recoverable under article 74.

*Id.*

23. See U.C.C. § 2-712 (1987) (stating that "[a]fter a breach . . . the buyer may 'cover' by making in good faith and without unreasonable delay any reasonable purchase of or contract to purchase goods in substitution for those due from the seller").

24. See *id.* § 2-706 ("Under the conditions stated [previously], . . . the seller may resell the goods concerned or the undelivered balance thereof.").

25. C.I.S.G., *supra* note 1, art. 76. Article 76 provides:

(1) If the contract is avoided and there is a current price for the goods, the party claiming damages may, if he has not made a purchase or resale under Article 75, recover the difference between the price fixed by the contract and the current price at the time of avoidance as well as any further damages recoverable under article 74. If, however, the party claiming damages has avoided the contract after taking over the goods, the current price at the time of such taking over shall be applied instead of the current price at the time of avoidance.

(2) For the purposes of the preceding paragraph, the current price is the price prevailing at the place where delivery of the goods should have been made or, if there is no current price at that place, the price at such other place as serves as a reasonable substitute, making due allowance for differences in the cost of transporting the goods.

*Id.*

26. See U.C.C. §§ 2-708, 2-713 (1987).

is not easy to attain when the parties realize, only after a breach, that each had different expectations.

There is no better illustration of this problem than in cases seeking consequential damages, in which each party foresaw something different. *Hadley v. Baxendale*, the opinion which laid the foundation for consequential damages, highlights this scenario.<sup>27</sup> One party foresaw that late delivery of a parcel would cause a loss of profits; the other foresaw only a loss of the rental value of the goods in the parcel for the period of the delay.<sup>28</sup>

#### IV. SOME COMMENTS ON OBSERVED TRENDS

Recent cases indicate that the courts now exhibit more concern for a party injured by a breach of contract than was the case in the nineteenth century. This trend is not easy to document because such a generalization has to be based on one's perception of how a court has viewed the facts of individual cases. Among the many cases in which the recovery of consequential damages is sought, the various fact patterns are sufficiently different to render conclusions about their results reckless.<sup>29</sup>

Still, there are several indications that the courts are better protecting the injured party. First, there has been a change in the wording of the *Hadley* rule. Second, commentators who have made a broader study of contract law have noted an expansion of the *Hadley* rule to the benefit of the injured party.<sup>30</sup> Third, there has been a change in the disposition of cases which concern carriers, cases involving the same type of contract or undertaking as *Hadley* itself. Especially indicative of these changes is the court's disposition of the injured party's claim in *Koufos v. C. Czarnikow, Ltd. (The Heron II)*.<sup>31</sup> *The Heron II* changed the rule on conse-

27. *Hadley v. Baxendale*, 156 Eng. Rep. 145 (Ex. 1854).

28. *Hadley* involved the rendition of a service, the *delivery* of goods, not the sale of goods themselves. *Id.* The rule of *Hadley* subsequently has extended to goods cases as well.

29. See Smith, *The Rule in Hadley v. Baxendale*, 16 LAW Q. REV. 275, 280 (1900).

[I]f there is added an appreciation of the damages which will proximately follow on a failure to deliver, an appreciation which may depend on the knowledge of an indefinite number of additional facts, he may well be liable. . . . Of the same act one consequence may be natural in one set of circumstances, another in another.

*Id.* (emphasis added) (Smith was later Lord Birkenhead, the Lord Chancellor).

30. See F. KESSLER, G. GILMORE & A. KRONMAN, *CONTRACTS: CASES AND MATERIALS* 1111 (3d ed. 1986) (stating that "the restrictive interpretation of the true meaning of *Hadley v. Baxendale*, current in the nineteenth century, has in this century gradually been replaced by a more expansive one").

31. *Koufos v. C. Czarnikow, Ltd.* [1969] 1 App. Cas. 350 [The Heron II]; see *infra* notes 90-106 and accompanying text.



quential damages set forth in *The Parana*,<sup>32</sup> a case which had stood as precedent for almost one hundred years. The now discarded rule in *The Parana* restricted recovery for wrongful delay in delivery of goods (by sea) to interest on the value of the goods. In contrast, *The Heron II* allowed recovery for the injured party's loss of profits. The difference was a recovery of £4,183 instead of £172.<sup>33</sup> This development is significant in that unlike *Hadley*, *The Heron II* was decided by the House of Lords.<sup>34</sup>

Many international cases may be decided by arbitration proceedings instead of by litigation. In light of this fact, another indication of the trend toward better protection of the injured party is found in the results of arbitration proceedings. Recent literature indicates that there has been a gradual liberalization in allowing recovery of consequential damages.<sup>35</sup> The arbitration proceedings illustrate the key point—that the amount of knowledge necessary to put the breaching party on notice has changed.

Three developments illustrate this point. In earlier proceedings, if wrongful delay of a vessel resulted in losses due to such events as changes in the market, prior notice of the special circumstances indicating this result was required.<sup>36</sup> In a recent arbitration proceeding, however, no notice was required to recover for a loss caused by an increase in prices during the wrongful delay of a vessel,<sup>37</sup> a decision similar to the holding in *The Heron II*. Gradual liberalization in allowing recovery of consequential damages also may be observed in the approach taken by arbitration panels toward recovery of anticipated profits. While an earlier proceeding illustrates an unwillingness to grant anticipated profits,<sup>38</sup> an arbitration panel went so far in a later case as to construct the anticipated profits on its own accord (because neither

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32. *The Parana*, [1877] 2 P.D. 118.

33. For a short discussion of this, see Case Comment, *Contract and Tort: Measures of Damages*, 26 CAMBRIDGE L.J. 14 (1968).

34. Some terms in another earlier House of Lords' decision will be mentioned below. See *Monarch Steamship Co. v. Karlshamns Oljefabriker (A/B)*, [1949] App. Cas. 196.

35. Bulow, *supra* note 6, at 622. Bulow's paper was presented at the VI International Congress of Maritime Arbitrators held in Monaco in 1983.

36. *Kyosei Atlantic v. Steelmet Export Co.*, SMA No. 1383 (1979) (involving loss of profits on the sale of cargo due to the late arrival of a ship); *Amoco Trading International v. Azienda Lavorazione Minerali Affini*, SMA No. 1043 (1975) (involving loss of a purchase of crude oil due to failure to supply a vessel). Note: SMA refers to the Award service of the Society of Maritime Arbitrators. See Bulow, *supra* note 6, at 622.

37. *Phillips Petroleum Int'l (U.K.) v. Sentry Ref. Inc.*, SMA No. 1883 (1983).

38. *Irene Compania Naviera, S.A. v. Metal Transport Corp. v. Luria Brothers & Co.*, SMA No. 768 (1973).

party's approach to damages was acceptable).<sup>39</sup> Finally, one arbitration panel has awarded damages based on unjust enrichment,<sup>40</sup> a result suggested a few years earlier in an article concerning recovery of lost profits under the UCC.<sup>41</sup>

## V. THE BENEFITS OF THE TREND

To the extent that recovery is easier, the injured party's expectations are more adequately protected than in the past. In the past, leading cases expressed much concern that the seller of services or goods in breach of contract not be burdened with a large verdict. But those cases contain little discussion revealing concern that the injured party will be burdened with an equally large loss that will not be reimbursed because of failure to recover damages.

Some sensitivity for the injured party appeared about ninety years ago in a noted article on *Hadley* by F.E. Smith.<sup>42</sup> Previously, J. Mayne in his treatise on damages had shown sympathy for the breaching party and asked, "[b]ut ought not the onus of making a contract rather to lie on the party who seeks to extend the liability of another than upon him who merely seeks to restrain his own within its original limits?"<sup>43</sup> In response to Mayne's sympathy, Smith replied, "[t]his argument seems to ignore completely the rationale of the rule that 'everyone who breaks a contract shall pay for its natural consequences.'"<sup>44</sup> Smith further criticized the rule that in cases of breach of contract by non-payment of money, the damages were not to exceed legal interest from the day that payment became due. Here, Smith argued, "a completely arbitrary standard is substituted for the principle of compensation."<sup>45</sup>

More recently, in the United States, an article by Richard Schiro indicated sympathy for the buyer injured by the breach of a sales contract and presented a rationale for minimum recov-

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39. *Earl Shipping Co. v. Afran Transport*, SMA No. 1674B (1983).

40. See Bulow, *supra* note 6, at 630-31 (citing *Sanko Steamship Co. v. Korea Shipping Corp.*, SMA No. 1804 (1983); *Maritime Overseas Corp. v. SPC Shipping Inc.*, SMA No. 1801 (1983); *Unimarine Inc. v. The Afghan Fertilizer Co.*, SMA No. 1703 (1982)).

41. See Schiro, *Prospecting for Lost Profits in the Uniform Commercial Code: The Buyer's Dilemmas*, 52 S. CAL. L. REV. 1727 (1979).

42. See Smith, *supra* note 29.

43. J. MAYNE, *DAMAGES*, 30-31 (6th ed. 1899).

44. Smith, *supra* note 29, at 280.

45. *Id.* at 285-86.

ery.<sup>46</sup> Before acknowledging some liberalization in favor of the victim,<sup>47</sup> the author lamented, “[o]f the four elements in the formula for recovering lost profits—causation, foreseeability, certainty, and mitigation—it appears today that foreseeability and certainty work an unduly severe penalty upon nonbreaching buyers seeking such recoveries in sales of goods transactions.”<sup>48</sup>

If there is even a gradual shift toward some concern for the party injured by the breach of contract, such a shift certainly is overdue. Consider some of the problems a U.S. plaintiff encounters in the battle to be compensated adequately. The plaintiff faces not only the court’s requirement that damages be foreseeable, but also the sometimes difficult task of proving with certainty the amount of loss.<sup>49</sup> There are, of course, occasions when the two requirements overlap, such as when a contingency makes the plaintiff’s loss both uncertain and unforeseeable.<sup>50</sup> While the law does not demand absolute certainty,<sup>51</sup> it does require that the evidence establish the loss as reasonably certain.<sup>52</sup> There is no gauge by which to measure reasonableness mechanically. In general, the courts have required greater certainty in cases of breach of contract than in tort cases.<sup>53</sup> For the buyer who has suffered either because of a failure to receive goods or because of a breach of warranty, the certainty rule, like the rule requiring foreseeability, has played an important role in claims for lost profits.<sup>54</sup> In recognition of this trend, the requirements of the rule of certainty were intended to be relaxed under the UCC.<sup>55</sup> There is, in fact, evidence that the UCC has eased

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46. See Schiro, *supra* note 41.

47. *Id.* at 1752 (stating: “Nevertheless, as a prelude to the ensuing discussion on ‘modernizing’ the foreseeability and certainty rules, some trends can be discerned. Both rules have been liberalized”).

48. *Id.* at 1729.

49. For an explanation of the term “remote”, see Bulow, *infra* note 130. It also would be difficult to prove such losses with any degree of certainty.

50. For examples of this overlap, see Comment, *Lost Profits as Contract Damages: Problems of Proof and Limitations on Recovery*, 65 YALE L.J. 992, 998 n.35 (1956).

51. For example, the Fifth Circuit has stated that “in a suit on a contract, we do not require exactness, only that there was enough evidence for the district court to estimate the amount of damages with reasonable certainty.” *Nobs Chem., U.S.A., Inc. v. Koppers Co.*, 616 F.2d 212, 217 (5th Cir. 1980) (citing *Fredonis Broadcasting Corp. v. RCA Corp.*, 481 F.2d 781, 804 (5th Cir. 1973)).

52. RESTATEMENT (SECOND) OF CONTRACTS § 352 (1979) (providing that “[d]amages are not recoverable for loss beyond an amount that the evidence permits to be established with reasonable certainty”).

53. See *id.* § 352 comment a.

54. See *id.*

55. The comments to two sections of the Uniform Commercial Code on damages

the requirement of certainty.<sup>56</sup>

In the United States, the plaintiff has a further disadvantage in suits for breach of contract. In theory, even if the plaintiff prevails, only the expectation interest is protected; in reality, the plaintiff is not going to break even. In England and the civil law countries, a prevailing plaintiff may recover attorney's fees,<sup>57</sup> while the U.S. plaintiff cannot recover money to pay court fees not charged to the defendant or money to repay for time lost gathering evidence and appearing in court. One function served by the recovery of monetary awards for pain and suffering (if the recovery is large enough) in personal injury cases is that the plaintiff can pay the attorney from this award and still have money remaining to cover out-of-pocket expenses. Because no such recovery exists in a breach of contract suit against a seller of goods, even a buyer who theoretically is made whole will in actuality not be. Thus, for these many reasons, the injured party does not fare well under the present rules.<sup>58</sup>

Commentators have stated that one of the chief purposes for awarding damages was to discourage breaches of contract.<sup>59</sup> Nevertheless, potential damages for breach of contract apparently do not influence conduct enough.<sup>60</sup> This is not to say that

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reject any requirement of mathematical accuracy in satisfying the certainty requirement. One comment provides that one purpose of that section is "to reject any doctrine that damages must be calculable with mathematical accuracy" and that "[c]ompensatory damages . . . have to be proved with whatever definiteness and accuracy the facts permit, but no more." U.C.C. § 1-106 comment 1. Another section repeats this, referring to section 1-106 without specifying it, adding "[l]oss may be determined in any manner which is reasonable under the circumstances." U.C.C. § 2-715 comment 4.

After referring to the first of these comments, the *Restatement* states "[f]urthermore, increasing receptiveness on the part of courts to proof by sophisticated economic and financial data and by expert opinion has made it easier to meet the requirement of certainty." RESTATEMENT (SECOND) OF CONTRACTS § 352 comment a (1979).

56. See Schiro, *supra* note 41, at 1753.

57. See Ehrenzweig, *Reimbursement of Counsel Fees and the Great Society*, 54 CALIF. L. REV. 792, 798 (1966); Toran, *Settlement, Sanctions, and Attorney Fees: Comparing English Payments into Court and Proposed Rule 68*, 35 AM. U.L. REV. 301, 331 (1986).

58. See F. KESSLER, G. GILMORE, & A. KRONMAN, *supra* note 30, at 1113 (stating that "[p]erhaps a good deal of the difficulty that the courts have had with damage theory over the past hundred and thirty years is attributable to the fact that less-than-compensatory formulae have, somehow, had to be squared with the 'compensation' idea, without, at least overtly, abandoning either the formulae or the idea").

59. See, e.g., A. CORBIN, CONTRACTS § 998 (1964) ("[T]he chief purposes for which the remedy in damages for breach of contract is given are the prevention of similar breaches in the future and the avoidance of private war.").

60. See Farnsworth, *Legal Remedies for Breach of Contract*, 70 COLUM. L. REV. 1145, 1216 (1970) (stating that "[a]ll in all, our system of legal remedies for breach of contract, heavily influenced by the economic philosophy of free enterprise, has shown a

the problems of the breaching party are never entitled serious consideration. Some protection from liability is appealing in the case of one who breaks a contract that is difficult to perform. For some of these contracts, UCC section 2-615 permits the defense of commercial impracticability. This defense mirrors some of the requirements of the defense against liability for consequential damages. The impracticability required by UCC section 2-615 is not expressly described as unforeseen, but rather as "a contingency the non-occurrence of which was a basic assumption on which the contract was made."<sup>61</sup> Yet, the comments to that section use as a clarifying term "unforeseen,"<sup>62</sup> and courts interpreting section 2-615 speak of "foreseeability."<sup>63</sup> If in a difficult contract case the defendant is not successful in basing a defense of impracticability on lack of foreseeability (so as to avoid liability completely), the defendant still may be successful in using lack of foreseeability to avoid some liability for consequential damages. This is not to say that the same facts will be the basis of both defenses, only that the lack of foreseeability may be the common tool used in the two defenses. Once a court decides that the breacher assumed the risk of performance and is liable, the

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marked solicitude for men who do not keep their promises"); see also Mueller, *Contract Remedies: Business Fact and Legal Fantasy*, 1967 WIS. L. REV. 833, 835 (1967) (noting: "But even in the simple cases where the gamble both of establishing breach and of making proof of full indemnifiable loss is reduced to a minimum, it is an open secret that a contract breaker rarely stands to lose as much by his breach as he would by performance").

61. U.C.C. § 2-615 (1987). Section 2-615 provides in pertinent part:

Excuse by Failure of Presupposed Conditions Except so far as a seller may have assumed a greater obligation and subject to the preceding section on substituted performance:

- (a) Delay in delivery or non-delivery in whole or in part by a seller who complies with paragraphs (b) and (c) is not a breach of his duty under a contract of sale if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid . . . .

*Id.*

62. See U.C.C. § 2-615 comment 1 ("excus[ing] a seller from timely delivery of goods contracted for, where his performance has become commercially impracticable because of unforeseen supervening circumstances"); see also U.C.C. § 2-615 comment 4 (stating that "[i]ncreased cost alone does not excuse performance unless the rise in cost is due to some unforeseen contingency").

63. See, e.g., *Eastern Air Lines v. McDonnell Douglas Corp.*, 532 F.2d 957, 990 (5th Cir. 1976) (stating that "[e]xcusatory provisions which are phrased merely in general terms have long been construed as excusing only unforeseen events which make performance impracticable"); *Eastern Air Lines v. Gulf Oil Corp.*, 415 F. Supp. 429, 441 (S.D. Fla. 1975) (stating that the "[seller] would not prevail because the events . . . were reasonably foreseeable").

breacher is liable for the general damages which were naturally foreseeable, but not for other damages, unless the injury was otherwise foreseeable. It is but a short step to argue that nobody assumes the risk (or "foresees" the liability) of a duty to pay consequential damages that are in an amount commercially impracticable.

One must go further in the matter, however. An examination of the commercial impracticability case allows a comparative look at another matter concerning the distribution of gains and losses. When the defense of impracticability is denied to a seller who breaks a contract because of inflation, large costs may be imposed on that seller. The argument can be made that this burden is harsh and "undeserved."<sup>64</sup> However, the costs which the seller incurs are gains to the buyer. The counter-argument is that the defense should be allowed "only when the satisfaction sellers lose by enforcement outweighs the satisfaction buyers gain by it."<sup>65</sup>

With the exception of the cases of the better risk-bearers,<sup>66</sup> there are few times when imposing liability for consequential damages would mean that the breaching party (seller) would lose more satisfaction than the injured party (buyer) would gain. This situation is distinct from the impossibility case because the injured party has already lost. Losses reimbursed by consequential damages are not gains to the injured party. The question turns on whether the party will continue to bear the loss or theoretically "break even." If the party recovers, the recovery is only a reimbursement. A third party gains here, if there has been a gain at all. Consider two examples, breach of warranty resulting in property damage and failure to deliver to a buyer who would in return resell followed by inability to cover. If property has been damaged, money may go to a contractor who rebuilds a building, to another seller who sells replacement equipment, or to a mechanic who repairs the damage. Even if the work is done by employees of the injured party's own establishment, these third parties still must be paid for labor. Others must be paid for supplying materials. In the second case of failure to deliver, either the buyer's customer did without (and there was no gain

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64. See Schwartz, *Sales Law and Inflation*, 50 S. CAL. L. REV. 1 (1976) (acknowledging this argument).

65. *Id.* at 25.

66. See Stone, *infra* note 241 and accompanying text.

on that end of the bargain), or someone else filled the order (and gained thereby). This "someone else" earned the profit.

Finally, if the goal of denying damages is to encourage commerce, it is not clear why the seller has enjoyed such a favorable position. While facing the possibility of huge liability would discourage some from selling, surely facing the same liability (of a loss not to be repaid and to an extent controlled by the seller's willingness to perform) would discourage some from buying. True, the buyer, more often than the seller, will understand the true extent of the possible loss and can avoid the contract if the loss would be too great. But do we not assume that, for *Hadley* to apply, either the possible loss is one known by a reasonable person or notice of it must have been given to the seller? To use a current phrase, does not *Hadley* demand an "even playing field"? Is commerce not benefitted by encouraging buyers to buy as much as by encouraging sellers to sell?

## VI. SOME OBSERVATIONS ON *Hadley*

*Hadley v. Baxendale*<sup>67</sup> arose in nineteenth century England and concerned a breach of contract by a carrier who was late delivering goods. For those students of law who may have forgotten, the facts and result of *Hadley* can be briefly stated. A carrier agreed with a mill owner to carry a broken engine shaft to the manufacturer to serve as a pattern for the replacement shaft. Delivery of the shaft was unnecessarily delayed for five days due to the fault of the carrier. The mill owner sued for lost profits because the mill was shut down those extra five days, the only loss sustained as a result of the carrier's breach. There was, in effect, no claim for direct damages,<sup>68</sup> only consequential dam-

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67. *Hadley v. Baxendale*, 156 Eng. Rep. 145 (Ex. 1854). A well-researched study of the case and its background can be found in an article by Richard Danzig. See Danzig, *Hadley v. Baxendale: A Study in the Industrialization of the Law*, 4 J. LEGAL STUD. 249 (1975). The material also appeared, with some footnotes omitted, in R. DANZIG, *supra* note 5, at 76-107. See generally R. DELDERFIELD, *GIVE US THIS DAY* (1973); R. DELDERFIELD, *GOD IS AN ENGLISHMAN* (1970); R. DELDERFIELD, *THEIRS WAS THE KINGDOM* (1971) (three novels concerning a family in the business of carriage of goods by land from the 1850's to the beginning of World War I tell a colorful story of the times and the business). One of Delderfield's novels contains a reference to the firm sued in *Hadley*. On the page preceding the dedication in *THEIRS WAS THE KINGDOM* is found: "The author gratefully acknowledges the encouragement given him by the old-established firm of Messrs. Pickford." A reader not familiar with the *Hadley* case will understand this better by knowing that Pickford & Co. was the transport company which broke the contract in that case. Baxendale was the company's managing director.

68. These direct damages would have consisted of the value of the shaft's use during the delay, its rental value. See J. CALAMARI & J. PERILLO, *Contracts* 594 (2D ED. 1977).

ages.<sup>69</sup> The court decided that the mill owner should not recover.

Even though five simple sentences establish the facts and result of *Hadley*, disagreement about the import of the case still exists. First, there is disagreement about the effect of *Hadley* with respect to prior law. Conventional teaching is that awards were more or less out of control before the case, with large awards often going to the plaintiff.<sup>70</sup> After *Hadley*, many authorities believed that recoveries by plaintiffs were more limited.<sup>71</sup> On the other hand, Gilmore suggests that the case expanded liability by allowing for some lost profits and other consequential damages that previously were not recoverable.<sup>72</sup> Gilmore asserts that this affirmative aspect of the rule later came under attack as going too far.<sup>73</sup>

Probably the best evaluation of the case is that it sets down a principle and a rule. Fuller and Perdue state:

The [*Hadley v. Baxendale*] case may be said to stand for two propositions: (1) that it is not always wise to make the defaulting promisor pay for all the damage which follows as a consequence of his breach, and (2) that specifically the proper test for determining whether particular items of damage should be compensable is to inquire whether they should have been foreseen by the promisor at the time of the contract. The first aspect of the case is much more important than the second. In its first aspect the case bears an integral relation to the very bases of contract liability. It declares in effect that just as it is wise to refuse enforcement altogether to some promises (considerationless, unaccepted, "social" promises, etc.) so it is not wise to go too far in enforcing those promises which are deemed worthy of legal sanction. . .

In its second aspect *Hadley v. Baxendale* may be regarded as giving a grossly simplified answer to the question which its first aspect presents. To the question how far shall we go in charging to the defaulting promisor the consequences of his breach, it answers with what purports to be a single test, that of foreseeability. The simplicity and comprehensiveness of this test are largely a matter of illusion. In the first place, it is openly branded as inappropriate in certain situations where

69. This fact was admitted by counsel. See *Hadley*, 156 Eng. Rep. at 147.

70. See C. McCORMICK, HANDBOOK ON THE LAW OF DAMAGES 562-64 (1935) (suggesting that *Hadley* limited juries' discretion in awarding damages to those which were foreseeable at the time the parties contracted); see also R. DANZIG, *supra* note 5, at 81-83 (drawing the same conclusion that *Hadley* abridged juries' discretion).

71. See G. GILMORE, *supra* note 5, at 126 n.122 (concluding that *Hadley's* effect of controlling large jury damage verdicts by making all damage questions matters of law reviewable on appeal is a key aspect of the case).

72. *Id.* at 51-52.

73. *Id.* at 52.



the line is drawn much more closely in favor of the defaulting promisor than the test of foreseeability as normally understood would draw it. There are, therefore, exceptions to the test, to say nothing of authorities which reject it altogether as too burdensome to the defaulter. In the second place, it is clear that the test of foreseeability is less a definite test itself than a cover for a developing set of tests. As in the case of all "reasonable man" standards there is an element of circularity about the test of foreseeability. "For what should he have foreseen as a reasonable man? Those items of damage for which the court feels he ought to pay." The test of foreseeability is therefore subject to manipulation by the simple device of defining the characteristics of the hypothetical man who is doing the foreseeing. By a gradual process of judicial inclusion and exclusion this "man" acquires a complex personality: we begin to know just what "he" can "foresee" in this and that situation, and we end, not with one test but with a whole set of tests.<sup>74</sup>

The "first aspect" is a principle, a principle still evident in the law of damages as manifested in the UCC, the Restatement, and Article 74 of the C.I.S.G. The "second aspect" is what may be called the "rule" of the case. Because of the manipulation referred to by Fuller and Perdue, however, that rule no longer retains its original wording—or seeming intent—in the cases, the UCC, the Restatement, or the C.I.S.G.

The "rule"<sup>75</sup> was that the damages "should be such as may fairly and reasonable [sic] be considered either [1] arising naturally, *i.e.*, according to the usual course of things, from such breach of contract itself, or [2] such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it."<sup>76</sup> The *Hadley* rule, like Article 74 of the C.I.S.G., may be described as "a general rule for the calculation of damages for every loss suffered as a consequence of a breach of contract."<sup>77</sup>

The second area of disagreement, a minor one, is whether the

74. Fuller & Perdue, *The Reliance Interest in Contract Damages: I*, 46 YALE L.J. 52, 84-85 (1936).

75. See *Gee v. Lancashire & Yorkshire Ry.*, 158 Eng. Rep. 87, 91 (Ex. 1860) (opinion by Baron Wilde). The court stated that

although an excellent attempt was made in *Hadley v. Baxendale* to lay down a rule on the subject, it will be found that the rule is not capable of meeting all cases: and when the matter comes to be further considered, it will probably turn out that there is no such thing as a rule as to the legal measure of damages applicable in all cases.

*Id.*

76. *Hadley v. Baxendale*, 156 Eng. Rep. 145, 151 (Ex. 1854).

77. See Knapp, *supra* note 21, at 539.

rule consists of two parts or of only one part. The rule is often discussed as being two rules or one rule in two parts,<sup>78</sup> an approach reflected in the British Sale of Goods Act.<sup>79</sup> Sometimes the part, or "branch," of the rule following [1], above, is referred to as "Hadley 1" and that following [2] as "Hadley 2". Damages are recoverable under the "first rule" whether they are "contemplated" or not; the damages are such that in the ordinary course, anyone should realize that those damages will follow naturally from a breach. These damages are referred to as ordinary or general damages. Damages are recoverable under the "second rule," however, only if the damages are "contemplated." Something else must cause this contemplation; one example is the knowledge of a reasonable person or perhaps a reasonable merchant. Another example is proper notice by the plaintiff to the defendant before the breach.<sup>80</sup>

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78. See A. FARNSWORTH, *CONTRACTS* 874 (1982); J. WHITE AND R. SUMMERS, *supra* note 5, at 441-42; Bulow, *supra* note 6, at 623. The New York Law Revision Commission, when considering the adoption of the U.C.C. and considering in particular § 2-710 (incidental damages), concluded that the "first branch" of the rule allowed recovery of incidental damages. See 1 STATE OF NEW YORK LAW REVISION COMMISSION REPORT 696 (1980) [hereinafter NEW YORK REPORT]; see also Gray v. West, 608 S.W.2d 771, 781 (Tex. Civ. App. 1980) (holding that the Hadley 2 rule requiring that the damages be in contemplation of the parties does not apply to incidental as distinguished from consequential damages); The Heron II, [1969] 1 App. Cas. 350, 357-59, 379 (showing that when counsel for the respondents argued that it was a Hadley 1 case, counsel for the appellants did not dispute this point); Victoria Laundry (Windsor), Ltd. v. Newman Indus., [1949] 2 K.B. 528, 536 (C.A.) (referring to the judge below, Lord Asquith stated "that the loss of profit claimed was . . . recoverable, if at all, only under the second rule in *Hadley v. Baxendale*").

79. See The Sale of Goods Act (1893), reprinted in M. CHALMERS, *THE SALE OF GOODS ACT 1893* § 50(2) (1924) (measuring the seller's damages in a suit for non-acceptance of the goods); *id.* § 51(2) (measuring damages for non-delivery); *id.* § 53(2) (measuring damages for breach of warranty). Reflecting the Hadley 1 rule, all three sections contain an identical provision stating that "[t]he measure of damages is the estimated loss directly and naturally resulting, in the ordinary course of events, from the . . . breach. *Id.* §§ 50(2), 51(2), 53(2)."

Reflecting the Hadley 2 rule, section 54 expresses the sentiment of the case, though it does not repeat the rule, by allowing "special" damages. In pertinent part, it states that "[n]othing in this Act shall affect the right of the buyer or the seller to recover interest or special damages in any case where by law interest or special damages may be recoverable, or to recover money paid where the consideration for the payment of it has failed." *Id.* § 54.

80. This notice was believed to have occurred in *Hadley* itself, although there was some confusion about this part of the case. Several writers seemed to think the rule of *Hadley v. Baxendale* was not followed in *Hadley v. Baxendale*. "Thus, in *Hadley v. Baxendale* itself, the carrier was told of the use to which the broken shaft was to be put and that the mill was shut down, but it was held that this was not enough, since it was not told that another shaft was not available!" C. McCORMICK, *supra* note 70, at 573; see also A. FARNSWORTH, *supra* note 78, at 874 n.7 (stating that the resulting loss of the miller's profits

Several commentators have concluded that there are actually three rules.<sup>81</sup> This conclusion follows from a further part of the *Hadley* opinion.<sup>82</sup> These commentators create three rules by splitting the second rule of *Hadley* into two parts. The first rule remains the same. Under the new second rule, the damages are "contemplated" if a "reasonable man in the position of the promisor would have foreseen" that they would result from the breach "in the great multitude of cases."<sup>83</sup> Under the new third rule, damages are "contemplated" if they "flow from special circumstances of the contract that were communicated to the breaching party at the time the contract was made."<sup>84</sup>

At the other extreme, several commentators have contended that there is no "rule on the legal measure of damages that applies in all cases."<sup>85</sup>

Finally, other commentators contend that there is really just one rule, "for damages which may reasonably be supposed to have been contemplated by the contracting parties, are damages

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could not then have been contemplated by the carrier since the carrier may have believed the miller would have a spare shaft); Fuller and Perdue, *supra* note 74, at 86 (same).

Any inconsistency between the words and the result did not seem to bother Mayne, who also reported that the clerk had been informed. See J. MAYNE, *supra* note 43, at 7.

The reason for the confusion was that in a part of the report of the case it was said that notice had been given to one of the carrier's clerks by someone from the mill. See *Hadley*, 156 Eng. Rep. at 145, 147. However, in *Victoria Laundry (Windsor), Ltd. v. Newman Indus.*, [1949] 2 K.B. 528, 537 (C.A.), it was noted that this statement must have been in error or else the case would have gone the other way. See *infra* note 111 for this explanation by Lord Asquith. For discussion on whether this might have been an agency problem, since notice to the company might not have been sufficient to charge the company, see R. DANZIG, *supra* note 5, at 86-87.

81. W. HAWKLAND, UNIFORM COMMERCIAL CODE SERIES § 2-715:03, at 395 (1984).

82. *Hadley v. Baxendale*, 156 Eng. Rep. 145 (Ex. 1854). The relevant portion of *Hadley* states:

Now if the special circumstances under which the contract was actually made were communicated by the plaintiffs to the defendants, and thus made known to both parties, the damages resulting from the breach of such contract, which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from a breach of contract under those special circumstances so known and communicated. On the other hand, if these special circumstances were wholly unknown to the party breaking the contract, he, at most, could only be supposed to have had in his contemplation the amount of injury which would arise generally, and in the great multitude of cases not affected by any special circumstances, from such a breach of contract.

*Id.* at 151.

83. W. HAWKLAND, *supra* note 81, at 354.

84. *Id.*

85. See *Gee v. Lancashire & Yorkshire Ry.*, 158 Eng. Rep. 87, 91 (Ex. 1860).

which naturally arise from a breach of contract."<sup>86</sup> That is true enough. Dividing the law into two rules reminds one of the legendary farmer who had a large cat and a small cat. The farmer cut two holes in his barn door, a large one for the large cat to enter and a small one for the small cat. Just as the large hole would have done for both, so "contemplated damages" could apply both to damages which are contemplated because they "naturally arise" and to damages contemplated because some special information was possessed by the parties. Ignoring the separate "branches" also saves an analyst from having to decide which part is applied in a case where the answer is not certain.

Nevertheless, dividing the rule into two parts helps analyze given situations.<sup>87</sup> If the damages follow naturally as a result of the breach, as general damages, the court need look no further. But if the damages are of the type contemplated, foreseeable, only when the buyer or some other source gives the seller special information, that is, notice of the potential loss, the court must decide if the source adequately did so. The court must first, of course, decide which of these two situations is presented by the facts of the case.<sup>88</sup> Because Article 74 of the C.I.S.G. does not contain two parts, or branches, there is no need to conceptualize into which part of the *Hadley* rule a loss governed by the C.I.S.G. belongs. Under Article 74 of the C.I.S.G., damage is classified as either foreseeable or not foreseeable.

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86. *Smeed v. Foord*, 120 Eng. Rep. 1035, 1040 (K.B. 1859) (Crompton, J.). In *The Heron II* case, Lord Reid wrote as if the rule had two "branches" saying:

[I]n cases like *Hadley v. Baxendale* or the present case . . . [t]he crucial question is whether . . . [the defendant] should . . . have realised that such loss was sufficiently likely . . . to make it proper to hold that the loss flowed naturally from the breach or that loss of that kind should have been within his contemplation.

The *Heron II*, [1969] 1 App. Cas. 350, 385. Lord Reid went on to state, however, that, "I do not think that it was intended that there were to be two rules or that two different standards or tests to be applied." *Id.*; see also Adams, "*Hadley v. Baxendale*" and the *Contract/Tort Dichotomy*, 8 ANGLO-AM. L. REV. 147 (1979) (stating that the two "limbs" of *Hadley* tend to be seen today as merely parts of a single rule); James, *Measure of Damages in Contract and Tort-Law and Fact*, 13 MOD. L. REV. 36, 39 (1950) (arguing that both parts of the *Hadley* rule "are only alternative ways of stating the same proposition"); Smith, *supra* note 29, at 277 (reaching the same conclusion that "*Hadley v. Baxendale* then lays down one positive rule, and one only").

87. G. CHESHIRE & C. FIFOOT, *LAW OF CONTRACT* 493 n.1 (3d ed. 1952) (in giving their reason for subdividing the rule, the authors stated that "in a textbook at any rate, it facilitates exposition to deal separately with the normal and abnormal").

88. The *Heron II*, [1969] 1 App. Cas. at 416 (stating that "there is sometimes difference of opinion as to which is the part [i.e. *Hadley 1* or *Hadley 2*] which governs a particular case and it may be that both parts govern it"). No case is cited or example given.

## VII. CONSIDERING CLAUSES IN ARTICLE 74

Seven clauses in Article 74 are the "bare bones" which a court must analyze. These clauses are: "Such damages may not exceed" the loss which "the party in breach" "foresaw or ought to have foreseen" "at the time of the conclusion of the contract" in light of the "facts and matters of which he then knew or ought to have known" "as a possible" "consequence of the breach of contract". Let us examine each of these provisions.

## (a). The "party in breach"

For recovery, *Hadley* requires that a loss be "in the contemplation of the parties." Does it make any difference that Article 74 of the C.I.S.G. refers to only one of the parties? The C.I.S.G. article, in limiting reference to the party in breach, surely does not envision delivering a windfall to the plaintiff, because the plaintiff recovers something not foreseen. Rather, this language reflects the view that the focus should be on the party who will have to answer for the amount of the loss.<sup>89</sup> No case has been found in which recovery was denied because the injured party did not foresee the loss.

## (b). "Foresaw or ought to have foreseen"

The choice of "foresaw" and "ought to have foreseen" instead of *Hadley*'s "in the contemplation of the parties" is especially significant in light of British cases. The question is whether the choice of the word "foreseeable" (short for "ought to have foreseen") instead of "contemplated" should make a difference in the scope of liability.<sup>90</sup> A plain reading of the words suggests that a difference in the scope of liability apparently is intended. Under *Hadley*, the damages must actually be "contemplated" and not merely "foreseeable." Thus, a rule that provides that damages only need to be "foreseeable" surely ought to narrow the

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89. A. CORBIN, *supra* note 59, § 1010.

The question always turns on whether the *defendant* had reason to foresee the injury. No doubt the plaintiff nearly always knows his own business and circumstances better than the defendant . . . Therefore, when courts say that both must have had reason to foresee the injury, the meaning is that the defendant must have had reason to foresee it.

*Id.* (emphasis added).

90. See, e.g., *H. Parsons (Livestock) Ltd. v. Uttley Ingham & Co.*, [1978] 1 All E.R. 525, 532 (opinion by Lord Denning stating that "I find it difficult to . . . draw a distinction between what a man 'contemplates' and what he 'foresees.' I soon begin to get out of my depth. I cannot swim in this sea of semantic exercises").

limitations of *Hadley* and widen the scope of recovery.<sup>91</sup> Indeed, the House of Lords in *The Heron II*, as will be shown below, thought that such a term would do so and explicitly rejected the word "foreseeable."<sup>92</sup> Yet is the connotation of "contemplation" used in legal circles in 1854, the year *Hadley* was decided, clear? Could it be that "foreseeable" and "in the contemplation" were interchangeable at that time?

An analysis of this point can be made by referring to the Louisiana Civil Code, which was translated into English both before and after *Hadley*. Before *Hadley* was decided, the Civil Code's section on consequential damages had used both "contemplated" (and "contemplation") and "foreseeable." In the Civil Code of 1825, Article 1928 provided that when the party breaching the contract had not been guilty of fraud or bad faith, that party was liable only for such damages as were "contemplated, or may reasonably supposed to have entered into the contemplation of the parties." When the "inexecution" had proceeded from fraud or bad faith, however, the breaching party "shall not only be liable to such damages as were, or might have been foreseen at the time of making the contract, but also such as are the immediate and direct consequence of the breach of that contract."<sup>93</sup> The French

91. A. FARNSWORTH, *supra* note 78, at 876-77.

92. *The Heron II*, [1969] 1 App. Cas. at 385.

93. Civil Code of 1825, Article 1934 provided:

Where the object of the contract is anything but the payment of money, the damages due to the creditor for its breach are the amount of the loss he has sustained, and the profit of which he has been deprived, under the following exceptions and modifications:

1. When the debtor has been guilty of no fraud or bad faith, he is liable only for such damages as were contemplated, or may reasonably be supposed to have entered into the contemplation of the parties at the time of the contract. By bad faith in this and the next rule, it is not meant the mere breach of faith in not complying with the contract, but a designed breach of it from some motive of interest or ill will.

2. When the inexecution of the contract has proceeded from fraud or bad faith, the debtor shall not only be liable to such damages as were, or might have been foreseen at the time of making the contract, but also to such as are the immediate and direct consequence of the breach of the contract; but even when there is fraud, the damages cannot exceed this.

The wording in the 1825 Code was translated from the French:

Lorsque l'objet du contrat consiste dans toute autre chose que le paiement d'une somme d'argent, les dommages dûs au créancier pour la violation du contrat, sont de la perte qu'il a faite, ou du gain dont il a été privé, sauf les exceptions et les modifications ci-après:

1. Lorsque le débiteur n'a été coupable d'aucune fraude ou mauvaise foi, il n'est sujet qu'aux dommages que les parties ont eu ou peuvent raisonnablement être supposées avoir eu en vue, au temps du contrat . . . .

2. Quand l'inexécution du contrat est le résultat de la fraude ou de la mauvaise foi, le débiteur est sujet, non seulement à tous les dommages qui ont

version from which the Code was translated used “avoir eu en vue” (“have had in view”, literally) in the first paragraph and “prevus” (foreseen) in the second, and Article 1934 of the Revised Civil Code of 1870 (after *Hadley*, that is) used this same translation.<sup>94</sup> Could the words have been interchangeable to the French at that time?

Interestingly, in his treatise, McCormick refers to the French Civil Code which “includes clearly the idea adopted in *Hadley v. Baxendale*” and then offers his own translation: “A debtor is only liable for the damages [and interest] which have been *foreseen* or which could have been *foreseen* . . . .”<sup>95</sup> The quote is from a 1930 translation of the Code from the French.<sup>96</sup>

To return to the use of both “contemplated” and “foreseeable” in the Louisiana Code, two possibilities exist. First, there may have been three categories of damages: “contemplated” damages, “foreseeable” damages, and “immediate and direct” damages. Alternatively, there may have been two categories: “contemplated” (or “foreseeable,” an interchangeable word) and “immediate and direct.” This second possibility is the more probable if, in the clause covering fraud and bad faith, “not only” preceding “foreseeable” was used to indicate “not only foreseeable - or contemplated if you will, as used above in the section on good faith breach.” On the other hand, it is possible that “not only . . . but also” indicated “both foreseeable [a new category in

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été ou pu être prévus à l'époque où le contrat a été fait, mais encore à ceux qui sont la conséquence immédiate et directe de la violation du contrat.

COMPILED ED. LA. CIV. CODE art. 1934 (1972).

The reader may wish to compare similar wording in the French text of the C.I.S.G. Article 74: “[c]es dommages-intérêts ne peuvent être supérieurs à la perte subie et au gain manqué que la partie en défaut avait prévus ou aurait dû prévoir au moment de la conclusion du contrat . . . .” C.I.S.G., *supra* note 1, art. 74.

The present Louisiana Code sections (dating from 1984) both use “foreseeable”:

Art. 1996. Obligor in good faith.

An obligor in good faith is liable only for the damages that were foreseeable at the time the contract was made.

Art. 1997. Obligor in bad faith.

An obligor in bad faith is liable for all the damages, foreseeable or not, that are a direct consequence of his failure to perform. LA. CIV. CODE ANN. arts. 1996-97 (West 1987).

94. LA. CIV. CODE ANN. art. 1934 (West 1987).

95. C. McCORMICK, *supra* note 70, at 563 n.10 (emphasis added).

96. *See id.* For a later translation, see G. BERMANN, H. DE VRIES, & N. GALSON, *FRENCH LAW: CONSTITUTION AND SELECTIVE LEGISLATION* (1989). “Art. 1150. The obligor is liable only for the damages foreseen or which could have been foreseen at the time of the contract, so long as it is not due to his fraud that the obligation has not been performed.” *Id.* art. 1150.

addition to "contemplated" used in the section on good faith breach] . . . and those that are immediate and direct [another new category]." The division into only two categories would indicate that in the legal circles of the time, the two words were interchangeable.

Assuming there were two categories of damages, there are also at least two possibilities concerning the *Hadley* court's choice of "contemplation" instead of "foreseeable." Both possibilities assume that the court looked to the French Civil Code for guidance.<sup>97</sup> The first possibility is that, as *Hadley* did not make a distinction between good faith breaches and fraudulent or bad faith breaches, the judges, deeming the two words interchangeable, arbitrarily chose the first word that appeared. The second possibility is that, as *Hadley* was not concerned with a bad faith breach, the judges, though considering the words interchangeable, picked the word that appeared with the rule concerned with breaches not in bad faith.

Whatever the connotation in *Hadley*'s day, in time, most authorities in the United States<sup>98</sup>—and some in England<sup>99</sup>—equated "foreseeable" with "in the contemplation of the parties" and concluded that *Hadley* established a rule of foreseeability. The UCC, section 2-715(2),<sup>100</sup> allows for consequential damages in breaches of contracts for the sale of goods. Although the UCC uses the expression "had reason to know" rather than "contemplated" or "foreseeable," *Hadley v. Baxendale* is generally

97. Several sources suggest that the *Hadley* court was influenced by the French Civil Code. See, e.g., R. DANZIG, *supra* note 5, at 82 (commenting that the *Hadley* opinion mentioned the "sensible rule" adopted by the French); Smith, *supra* note 29, at 278.

98. Corbin contended that *Hadley* had adopted a "foreseeability" test. See A. CORBIN, *supra* note 59, § 1007 (explaining that natural consequences are those which are foreseeable). Corbin also commented that allowing recovery for injuries that are the natural result of the breach "seems to have no meaning other than that there was reason to foresee such injury." *Id.* § 1011; see also C. McCORMICK, *supra* note 70, at 565 (stating that *Hadley* "lays down a general standard of foreseeability of damage as at the time of the bargain"). A very recent U.S. case held the defendants liable because failure of cash registers to work would foreseeably create additional labor costs. See *Cricket Alley Corp. v. Data Terminal Sys., Inc.*, 732 P.2d 719, 724-25 (Kan. 1987).

99. *H. Parsons (Livestock) Ltd. v. Uttley Ingham & Co.*, [1978] 1 All E.R. 525, 536 (Scarman, J.) (expressing the view that any difference between "reasonably foreseeable" and "reasonably contemplated" was semantic). Until *The Heron II* decision, English cases reflected the same view. See, e.g., *Monarch Steamship Co. v. Karlshams Oljefabriker (A/B)*, [1949] App. Cas. 196, 214-15 (Lord Porter uses language such as "could reasonably have been foreseen" and "a shipowner ought to have foreseen" along with "ought reasonably have contemplated").

100. For the full text of U.C.C. § 2-715, see *infra* note 177.



accepted as the source of that section.<sup>101</sup> Restatement section 351(2) uses "foreseeable," and (2)(b) uses "foreseeable . . . because . . . [the party in breach had] reason to know";<sup>102</sup> the language "in the contemplation of" is not used.

As a final observation, although nineteenth-century judges may have thought "in the contemplation of" and "foreseeable" to be interchangeable, later judges may not have agreed, instead believing that "foreseeable" demanded a more generous result, and decided the cases accordingly. In the New York Study of the UCC, one finds that three decades ago there was a thought that changing the contemplation wording would make a difference in the results of applying the test.<sup>103</sup> The study further indicated that the results of other cases supported this conclusion.<sup>104</sup> There could be another explanation in the sale of goods cases, however. A liberal application of the requirement of foreseeability may, for instance, be due to a combination of the influence of Professor Corbin, UCC section 2-715(2), and the suggestions found in the Comments to section 2-715(2).<sup>105</sup>

Whatever the cause of liberalization in the United States, the British case, *The Heron II*, rejected "foreseeable" in favor of the "contemplation" test.<sup>106</sup>

(c). "As a possible" (and more on "foreseeable")

The phrase "as a possible consequence" appears in Article 74, while *Hadley* chose "as a probable result." Neither "possible" nor "probable" appears in UCC section 2-715,<sup>107</sup> but the Restatement section 351 uses "probable."<sup>108</sup> Thus the language

101. See, e.g., J. WHITE & R. SUMMERS, *supra* note 5, at 445-46.

102. For the full text of the *Restatement* § 351, see *infra* note 236.

103. 1 NEW YORK REPORT, *supra* note 78, at 702. "As to [consequential] damages, it may fairly be said that the New York courts have generally purported to follow the 'contemplation' test and that the application of this test has narrowed recovery of damages . . . probably more than would the 'had reason to know' test of the Code." *Id.* (footnote omitted).

104. *Id.* at 702. "In view of [the] divergences in New York case law, it seems that the test adopted in Section 2-715(2)(a) . . . will probably liberalize [present New York law] somewhat, in accordance with the Restatement test and the trend of more recent cases in the state courts." *Id.* (footnotes omitted); see also Comment, *supra* note 50, at 1009 (noting that "[e]ven more significant is the decreasing effect of the foreseeability rule as a limitation on damages").

105. See J. WHITE & R. SUMMERS, *supra* note 5, at 445-47 (discussing the influence of these three elements in the development of the present foreseeability test).

106. See *The Heron II*, [1969] 1 App. Cas. 350.

107. See *infra* note 177.

108. See *infra* note 236.

of the C.I.S.G. ostensibly widens the area of liability imposed upon a breaching party. Hopefully, "possible" will not cause in international sales cases the same speculation that "probable" has caused in the British cases.

A leading case on consequential damages in the mid-twentieth century, *Victoria Laundry (Windsor), Ltd. v. Newman Industries*,<sup>109</sup> involved the sale of a large boiler which was late being delivered. The plaintiffs claimed as part of the damages the loss of profits from lucrative special contracts. Recovery was denied because the defendants had no knowledge of these special contracts. The suit was not against the carrier, as in *Hadley*, but instead against the seller. *Victoria Laundry* explained one question that had puzzled some people—was the rule of *Hadley* applied in *Hadley* or not?<sup>110</sup> The headnote in *Hadley* stated that the carrier's clerk was given notice about the shaft's being needed to run the mill. If the clerk was given notice, why was recovery not allowed by the court? *Victoria Laundry* explained that the headnote was misleading about the notice, and that notice was not actually given.<sup>111</sup> Another contribution of the case was an attempt by Lord Asquith to describe the required degree of probability that the loss would occur. Lord Asquith effectively described it as "liable to result," and such that "a reasonable man" "could foresee" that the loss was "likely so to result," or a "serious possibility," or "a real danger," and the probability was "on the cards."<sup>112</sup> Prior cases

109. See *Victoria Laundry (Windsor), Ltd. v. Newman Indus.*, [1949] 2 K.B. 528, 536 (C.A.).

110. See *supra* note 80.

111. *Victoria Laundry*, [1949] 2 K.B. at 537.

The head-note is definitely misleading in so far as it says that the defendant's clerk, who attended at the office, was told that the mill was stopped and that the shaft must be delivered immediately. The same allegation figures in the statement of facts which are said on page 344 to have "appeared" at the trial before Crompton, J. If the Court of Exchequer had accepted these facts as established, the court must, one would suppose, have decided the case the other way round . . . But it is reasonably plain from Alderson B.'s judgment that the court rejected this evidence . . .

Id.

112. *Id.* at 540.

In order to make the contract-breaker liable under [*Hadley*] it is not necessary that he should actually have asked himself what loss is liable to result from a breach . . . It suffices that, if he had considered the question, he would as a reasonable man have concluded that the loss in question was liable to result . . . Nor . . . to make a particular loss recoverable, need it be proved that upon a given state of knowledge the defendant could, as a reasonable man, foresee that a breach must necessarily result in that loss. It is enough if he could foresee it was likely so to result. It is indeed enough . . . if the loss (or some factor without which it would not have occurred) is a "serious possibility" or a "real danger". For short, we have used the word "liable" to result. Possibly the

had similarly offered various phrases to explain the meaning of "probable."<sup>113</sup>

Twenty years later, however, the Law Lords of the House of Lords in *The Heron II*, thoroughly critiqued Lord Asquith's statements.<sup>114</sup> *The Heron II* involved a suit against a shipowner for delay in carrying sugar; the consequential damages sought consisted of money lost because the price of sugar had dropped during the delay.<sup>115</sup> In *Victoria Laundry*, Lord Asquith said that the party injured by a breach was entitled to recover "such part of the loss actually resulting as was at the time of the contract reasonably foreseeable as liable to result from the breach."<sup>116</sup> In *The Heron II*, Lord Reid did not agree, saying that a great many "extremely unlikely results are reasonably foreseeable."<sup>117</sup> Also criticized were the phrases "liable to result",<sup>118</sup> a "serious possibility", "a real danger", and "on the cards."<sup>119</sup> Lord Pearce, on the other hand, wrote that the "language of the judgement in the *Victoria Laundry* case was a justifiable and valuable clarification of the principles which *Hadley v. Baxendale* intended to express. Even if it went further than that, it was in my opinion right."<sup>120</sup> Nevertheless, the views of the remaining justices were closer to Lord Reid's than to Lord Pearce's.<sup>121</sup>

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colloquialism "on the cards" indicates the meaning with some approach to accuracy.

*Id.*

113. See, e.g., *R. & H. Hall Ltd. v. W. H. Pim (Junior) & Co.*, 33 Com. Cas. 324, 329-30 (1928) (Lord Dunedin stating: "I do not think that 'probability' . . . means that the chances are all in favour of the event happening. To make a thing probable, it is enough, in my view, that there is an even chance of it happening."); see also *id.* at 336 (Lord Phillimore referred to "those damages which . . . are . . . recognized by the parties as those which in a particular case may result from a breach. . . . There may be cases where the word to be used might be 'will,' but there are also cases and more common cases where the word to use is 'may.'").

114. *The Heron II*, [1969] 1 App. Cas. 350.

115. *Id.* at 406.

116. *Victoria Laundry (Windsor), Ltd. v. Newman Indus.*, [1949] 2 K.B. 528, 539 (C.A.).

117. *The Heron II*, [1969] 1 App. Cas. at 389.

118. *Id.* at 389.

119. The first two of these quotations, a "serious possibility" and a "real danger," both of which appear in *Victoria Laundry*, [1949] 2 K.B. at 540, are credited to Lord du Parc in *Monarch Steamship Co.*, [1949] App. Cas. 196, 233-34, rather than Lord Asquith. Lord Asquith also used the colloquial phrase "on the cards" to indicate "the shade of meaning" of the phrase "liable to result." *Victoria Laundry*, [1949] 2 K.B. at 540. Lord Reid went so far in his criticism as to say, "If the tests of 'real danger' or 'serious possibility' . . . are to prevail in the future then let us cease to pay lip service to the rule in *Hadley v. Baxendale.*" *The Heron II*, [1969] 1 App. Cas. at 390.

120. *The Heron II*, [1969] 1 App. Cas. at 417.

121. Lord Upjohn did not think that Lord Asquith intended to alter the law. "If he

The justices in *The Heron II* gave individual views of "probable" and rejected the use of the term "foreseeable."<sup>122</sup> The reason was that "foreseeable" was the test for damages in torts, not breaches of contract, and that "foreseeable" was a different concept from "contemplat[ed]."<sup>123</sup> However, they unanimously held that the party injured by the breach was entitled to loss-of-market damages.

The British cases, unlike U.S. cases, reflect a formal approach to contract damages.<sup>124</sup> In addition to indicating a different approach, *The Heron II*, in rejecting the use of "foreseeable,"

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[did] . . . I would disagree with him." *Id.* at 424. Lord Hodson found guidance in the expression "in the great multitude of cases" but did not directly reject "liable to result." *Id.* at 411. Although the principles set down in *Victoria Laundry* had been referred to as creating a "landmark," *id.* at 389, Lord Morris of Borth-y-Gest simply described Lord Asquith's opinion as "a most valuable analysis of the rule [of *Hadley*]." *Id.* at 399.

122. Lord Reid thought that he should contemplate that the fall in price was "not unlikely to occur." *Id.* at 388. Lord Morris of Borth-y-Gest thought that he should contemplate that the fall was "liable to result or at least was not unlikely to result." *Id.* at 406. Lord Hodson also chose "liable to result." *Id.* at 410. Finally, the expressions "a serious possibility" or "a real danger" [that the price would fall], taken from *Monarch Steamship Co.*, [1949] App. Cas. at 233, were chosen by Lords Pearce and Upjohn. *The Heron II*, [1969] 1 App. Cas. at 425.

123. *The Heron II*, [1969] 1 App. Cas. at 422.

So the claim for damages [for breach of contract] must be the natural consequence of the breach or in the contemplation of the parties. But in tort a different test has been adopted . . . and I cannot accept the argument . . . that they remain the same. The test in tort . . . is that the tortfeasor is liable for any damage which he can reasonably foresee may happen as a result of the breach. . . . So the rules as to assessment of damages have diverged in the two cases, and nowadays the concept of "foreseeability" and "contemplation of the parties" are different concepts in the law.

*Id.* at 422 (opinion by Lord Upjohn).

[Also,] I am satisfied that the court did not intend that every type of damage which was reasonably foreseeable by the parties when the contract was made should either be considered as arising naturally, i.e., in the usual course of things, or be supposed to have been in the contemplation of the parties. . . . The parties are not supposed to contemplate as grounds for the recovery of damage any type of loss or damage which on the knowledge available to the defendant would appear to him as only likely to occur in a small minority of cases.

*Id.* at 385 (opinion by Lord Reid).

124. See, e.g., P. ATIYAH & R. SUMMERS, FORM AND SUBSTANCE IN ANGLO-AMERICAN LAW 84 (1987). Commenting on this, the two authors recently wrote:

In the English law of contract . . . the position overall remains more formal than in America. For example, the English law of contractual damages continues to be treated by judges and writers as governed by highly formal rules. Even with respect to problems which are inherently difficult to force into a framework of formal rules - such as the foreseeability principle of *Hadley v. Baxendale* - English courts still try to formulate the law in terms of specific formal rules and most English judges try (if, as some may think, rather futilely) to apply these rules formally.

*Id.*

adopted a British rule altogether different from the U.S. rule.<sup>125</sup> The language of the British rule makes it less likely that the defendant will have to pay consequential damages.<sup>126</sup> At least one conclusion can be drawn from this fact. As things stand now, U.S. cases should be more favorable for the injured party than British cases;<sup>127</sup> and if "foreseeable" and "possible" are measures of result, cases under Article 74 should provide more favorable recoveries also.

Nevertheless, this unfavorable position in England should be true only for "internal" or "national" cases. In measuring consequential damages in international sales, courts in England do not object to the use of either "foreseeable" or "possible." For, while England has not yet adopted the C.I.S.G., it has adopted the Convention relating to a Uniform Law on the International Sale of Goods (U.S.I.L.), Article 82 of which provides for the recovery of consequential damages which the party "ought to have foreseen . . . as a possible consequence of the breach of the contract."<sup>128</sup>

125. See Treitel, *Remedies for Breach of Contract*, 7 INT'L ENCY. COMP. L., ch. 16, at 64 (1976) [hereinafter *Remedies for Breach*] (concluding that in England, especially after *The Heron II*, the tendency is not to use foreseeability as a test; instead, the courts refer to consequences "within the contemplation of the parties" which may mean more highly probable than foreseeable). However, there is an indication that the expression 'foreseeability' is usable in English contract cases, even though it does not serve the same purpose as in the United States. As Treitel has noted: "It is clear that a higher degree of probability is required to satisfy the test of remoteness in contract than in tort and that in contract cases the expression "foreseeability" refers to this higher degree of probability." G. TREITEL, *THE LAW OF CONTRACT* 644 (4th ed. 1975).

126. Although the Restatement was copyrighted in 1981, and *The Heron II* case was decided in 1967, no mention is made of the case in the Reporter's Notes. Nevertheless, consideration was given to some English cases during the drafting period. In addition to *Hadley*, another old case, *Cory v. Thames Ironworks & Shipbuilding Co.*, 3 L.R.-Q.B. 181 (1868), is the basis of an illustration. Of the modern cases, the only English one mentioned is *Victoria Laundry*. So the influence, if any, of *The Heron II* as a common law case is not indicated.

127. Considering the remark of Judge Scarman, *supra* note 99, made nine years after *The Heron II*, matters are not entirely clear.

128. England adopted both of the two 1964 Hague Conventions by enacting the Uniform Law on the Formation of Contracts for the International Sale of Goods and the Uniform Law on the International Sale of Goods. See 39 HALSBURY'S STATUTES OF ENGLAND & WALES 20, 38 (4th ed. 1988).

Article 82 of the Convention provides:

Where the contract is not avoided, damages for a breach of contract by one party shall consist of a sum equal to the loss, including loss of profit, suffered by the other party. Such damages shall not exceed the loss which the party in breach ought to have foreseen at the time of the conclusion of the contract, in the light of the facts and matters which then were known or ought to have been known to him, as a possible consequence of the breach of the contract.

Convention Relating to the Uniform Sale of Goods, *supra* note 11.

Before leaving the concept, consider two connotations of foreseeable: remoteness and causation. In looking at the remoteness connotation, consider trying to determine if the legendary blacksmith (or farrier) who does a bad job replacing the horse's shoe should be liable for the loss of the battle or the war or the kingdom.<sup>129</sup> Should the answer depend on whether or not the blacksmith could foresee the loss? In U.S. case law, such problems of remoteness have been considered adequately covered by the "foreseeability" test.<sup>130</sup> In British law, the rule of *Hadley* also has been said to serve this purpose.<sup>131</sup> However, the same is not true

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129. Horror stories of this kind appear occasionally. One was told by Judge Willes, and Smith commented:

In *British Columbia Saw-mills Co. v. Nettleship*, 3 L.R.-C.P. 508, Willes J. refers to "the old case said to have been decided about two centuries and a half ago, where a man going to be married to an heiress, his horse having cast a shoe in the journey, employed a blacksmith to replace it, who did the work so unskillfully that the horse was lamed and the rider not arriving in time, the lad married another and the blacksmith was held liable for the loss of the marriage." It is hardly necessary to observe that the man of the anvil, even with notice of his customer's errand, could hardly have apprehended in the bride an *animus nubendi* so imperious and indiscriminating.

Smith, *supra* note 29, at 279.

A similar story appears in *Griffin v. Colver*, 16 N.Y. 489, 493 (1858), about a Canon of a church who because "of the non-delivery of a horse pursuant to an agreement, was prevented from arriving at this residence in time to collect his tithes." According to Farnsworth, the original source is probably 1 R. POTHIER, A TREATISE ON THE LAW OF OBLIGATIONS 91-92 (W. Evans trans. 1806). A. FARNSWORTH, *supra* note 78, at 841 n.13.

One U.S. court gave its answer to the problem of the poorly shod horse and the lost kingdom: "But in an action against the farrier, it would not have done to look beyond the loss of the shoe. To have charged him with accidental consequences would have worked his ruin." *Hargous v. Ablon & Boyd*, 5 Hill 472, 474 (N.Y.), *aff'd*, 3 Denio 406 (1843).

130. A. CORBIN, *supra* note 59, § 997. Corbin stated:

It is clear that mere remoteness in time or space is not in itself sufficient to prevent the recovery of damages for an injury. If the defendant in fact foresaw the injury and his conduct was planned to induce it, the fact that the train [sic] laid by him was a long one is immaterial. The extent of time or distance between the beach and the injury is to be considered in determining whether the latter could have been, or ought to have been, or was in fact foreseen by the defendant.

*Id.*; see also NEW YORK REPORT, *supra* note 78, at 702:

The term "consequential" damages is not a precise term, as it has sometimes been used to mean "too-remote-in-causation" damages. However, ordinarily it means damages deemed more remote than, or less foreseeable at the time of contracting than, the standard damages (market-price measure for non-delivery, rental value for delay, etc.).

KNAPP, COMMERCIAL DAMAGES § 1.04[2], at 1-14 (1986) ("In contract cases, the remoteness concept is usually expressed in terms of the 'foreseeability' doctrine springing from the landmark decision in *Hadley v. Baxendale*."); Bulow, *supra* note 6, at 631. It is not clear to this author whether "remote" was used as it is being used at this point in Bulow's article or as the equivalent of "uncertain" or whether the losses referred to were both uncertain and remote.

131. A. GUEST, ANSON'S LAW OF CONTRACT 555 (25th ed. 1979) (footnote omitted)

under the French Civil Code because, as one authority points out,<sup>132</sup> French law draws a distinction between damage which could have been foreseen,<sup>133</sup> and damage which is remote (or indirect).<sup>134</sup> Still, the principle of foreseeability was adopted as the leading test of remoteness in the U.S.I.L., an indication that the concept has some acceptance outside the common law system.<sup>135</sup>

In looking at "causation," suppose that a breach of contract causes an interruption of the victim's cash flow so that creditors force the victim out of business. The defendant argues that this situation was caused by the inherent weakness of the victim's financial condition rather than the breach.<sup>136</sup> In this case, causation may be handled as a separate problem by the court.<sup>137</sup> Going

("Certain losses may be too 'remote', and for these the plaintiff is not entitled to compensation. The foundation of the law on this subject is contained in the judgment of Alderson B. in the Court of Exchequer in the case of *Hadley v. Baxendale*."); see G. TREITEL, *supra* note 125, at 642; Smith, *supra* note 29, at 277-79.

132. *Remedies for Breach*, *supra* note 125, at 59.

133. The French Civil Code provides: "The obligor is liable only for the damages foreseen or which could have been foreseen at the time of the contract, so long as it is not due to his fraud that the obligation has not been performed." CODE CIVIL [C. CIV.] art. 1150 (Fr.), translated in G. BERMANN, H. DE VRIES, & N. GALSON, *supra* note 96.

134. Article 1151 of the French Civil Code provides:

Even in the case where nonperformance of the agreement is due to the fraud of the obligor, the damages may include only that portion of the loss sustained by the obligee and of the benefit of which he was deprived, which is the immediate and direct consequence of the nonperformance of the agreement.

*Id.* art. 1151.

135. G. TREITEL, *REMEDIES FOR BREACH OF CONTRACT* 150 (1988).

136. This view is suggested by the discussion of *Earl Shipping Co. v. Afran Transp., SMA No. 1674B* (1983). See Bulow, *supra* note 6, at 632. Where the breach is one of several causes, see Schiro, *supra* note 41, at 1751 n.75. Schiro states that

one defense to the assumption of causation is that the defendant's act was but one of several factors contributing to the loss and, therefore, that defendant should not be liable. The generally accepted reply is that defendant is liable if his action was a substantial factor in causing plaintiff's loss, even if not the only factor.

*Id.*

137. See Comment, *supra* note 50, at 997-1000. For cases where the courts have based decisions on causation as a separate limitation on recovery, see *Richardson v. Crone*, 127 Mont. 200, 202, 258 P.2d 970, 972 (1953) (referring to "supervening cause") and *Foss v. Pacific Tel. Co.*, 26 Wash.2d 92, 99, 173 P.2d 144, 152 (1946) (requiring "proximate cause"). For a more recent case where there was "foreseeability" but no causation, see *Overstreet v. Norden Laboratories*, 669 F.2d 1286 (6th Cir. 1982). In *Overstreet*, the buyer purchased Rhinomune to inoculate against a disease that caused abortions in mares. Although the mares were inoculated, some aborted.

The fact that the abortions were foreseeable if the Rhinomune did not work does not mean that the breach of warranty was the cause of the abortions. There was simply a failure to prevent an occurrence that nothing would have prevented, and [buyer] may not recover the value of the foals.

*Id.* at 1296.

further, a recent British case differentiated between causation and remoteness, stating that although "some of the relevant considerations are the same, "they are "quite different concepts."<sup>138</sup> Usually, however, "foreseeable" connotes "causation"; if a U.S. court finds that the damages were foreseeable, the court also finds that the breach caused the loss.<sup>139</sup> Thus, to the extent that a foreseeable loss means a loss not remote,<sup>140</sup> in England it does not also mean causation will automatically be inferred. German law also distinguishes causation from foreseeability.<sup>141</sup>

In the United States, remoteness and causation can overlap, as illustrated by an old case involving an erroneous invoice.<sup>142</sup> The defendant sold bales of cloth to the plaintiff. The invoice erroneously showed more yards of goods than there actually were. The goods were shipped into Mexico where the tariff was paid based on the larger amount. When the error was discovered, the seller reimbursed the buyer the amount of overpayment for the goods. The Mexican customs office, however, would not refund the overcharge on the tariff. In a suit by the buyer against the seller to recover the amount of the extra tariff charge, the court held that the seller was not liable for the extra tariff charged. The damage was too "remote." The court noted that "[a]ll this depends on the conduct of others, the mode of their dealing, the practice of a custom-house, or the laws of a foreign country; perhaps on the greater or less vigilance of the vendee or his agents."<sup>143</sup> It could also be argued that the "cause" of the loss was not the incorrect invoice but the refusal of the Mexicans to correct the error. Both points could be covered by saying that the defendant was unable to foresee the loss.

(d). "At the time of the conclusion of the contract"

The "at the time" (for determining what is foreseeable—or for having "reason to know") language in the C.I.S.G. is the same time as that set out in the *Hadley* rule, the UCC in section 2-

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138. A. CORBIN, *supra* note 59, § 1006 ("Our only test of causation . . . is foreseeability."); *see also* NEW YORK REPORT, *supra* note 78, at 702 (same).

139. *Stinnes Interoil GmbH v. A. Halcoussis & Co.* (The *Yanxilas* No. 2), 1 Lloyd's Rep. 676, 681-82 (1984).

140. *See supra* note 131 and accompanying text.

141. G. TREITEL, *supra* note 135, at 153; *see also* J. HONNOLD, *supra* note 9, at 411 n.7 (discussing the German concepts of "foreseeability").

142. *Hargous v. Ablon & Boyd*, 5 Hill 472 (N.Y.), *aff'd*, 3 Denio 406 (1843).

143. *Id.* at 475.



715(2)(a),<sup>144</sup> and the Restatement in section 351(1).<sup>145</sup> In a case following *Hadley, Gee v. Lancashire and Yorkshire Ry.*,<sup>146</sup> an English court suggested that the time rule be changed to allow for notice after the contract was made.<sup>147</sup> This suggestion was not accepted in later decisions,<sup>148</sup> and one recent British writer referred to the suggestion as "heresy."<sup>149</sup> Nonetheless, in his 1975 study of *Hadley*, Danzig argued for a similar rule.<sup>150</sup> Danzig described the rule of *Hadley* as "irrelevant to the modern age"<sup>151</sup> and argued that a rule allowing notice after the execution of the contract has merit in some cases.<sup>152</sup>

Danzig based this argument on the thesis that there are societal gains in certain breaches of contract, and applied the "efficient breach" theory to recovery of consequential damages. This theory, which debuted in 1970<sup>153</sup> and was dubbed in 1977,<sup>154</sup> has been discussed extensively.<sup>155</sup> Professor Linzer provided a suc-

144. U.C.C. § 2-715(2)(a).

145. RESTATEMENT (SECOND) OF CONTRACTS § 351(1); *see infra* note 236.

146. *Gee v. Lancashire & Yorkshire Ry.*, 158 Eng. Rep. 87 (Ex. 1860).

147. Baron Bramwell suggested that the *Hadley* rule might be further qualified:

[t]hat in the course of the performance of the contract one party may give notice to the other of any particular consequences which will result from the breaking of the contract, and then have a right to say: "If, after that notice, you persist in breaking the contract I shall claim the damages which will result from the breach."

*Id.* at 90.

148. *Globe Refining Co. v. Landa Cotton Oil Co.*, 190 U.S. 540, 544 (1903); *Gerwin v. Southeastern California Ass'n of Seventh Day Adventists*, 14 Cal. App. 3d 209, 220, 92 Cal. Rptr. 111, 118 (1971) (stating that "foreseeability . . . is to be determined as of the time the contract was entered into and not as of the time of the breach"); *see A. CORBIN, supra* note 59, § 1008 (stating that defendant must have reason to foresee the injury at the time he or she enters into the contract); *Farnsworth, supra* note 60, at 1203.

149. *Adams, supra* note 86, at 148.

150. R. DANZIG, *supra* note 5, at 98.

151. *Id.*

152. *Id.* at 103. "A more sophisticated rationale for the rule in this context might focus on its effect on a seller not at the time of his entering a contract, but rather at the time of his deciding whether to voluntarily breach or to risk breaching." *Id.*

153. Birmingham, *Breach of Contract, Damages Measures, and Economic Efficiency*, 24 RUTGERS L. REV. 273 (1970).

154. Goetz & Scott, *Liquidated Damages, Penalties and The Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach*, 77 COLUM. L. REV. 554 (1977).

155. In addition to Birmingham, *supra* note 153, and Goetz & Scott, *supra* note 154, *see* Barton, *The Economic Basis of Damages for Breach of Contract*, 1 J. LEGAL STUD. 277 (1972); Clarkson, Miller & Muris, *Liquidated Damages v. Penalties: Sense or Nonsense?*, 1978 WIS. L. REV. 351; Farber, *Reassessing the Economic Efficiency of Compensatory Damages for Breach of Contract*, 66 VA. L. REV. 1443 (1980); Jackson, 'Anticipatory Repudiation' and the Temporal Element of Contract Law: *An Economic Inquiry into Contract Damages in Cases of Prospective Nonperformance*, 31 STAN. L. REV. 69 (1978); Linzer, *On the Amoralism of Contract Remedies—Efficiency, Equity, and the Second Restatement*, 81 COLUM. L. REV. 111 (1981); Mac-

cinct summary of efficient breach:

In the context of contracts, efficiency theory suggests that promisors who breach increase society's welfare if their benefit exceeds the losses of their promisees. Such failure to perform, the so-called efficient breach of contract, is illustrated by the following. Assume that Athos owns a woodworking factory capable of taking on one more major project. He contracts to supply Porthos with 100,000 chairs at \$10 per chair, which will bring Athos a net profit of \$2 per chair, or \$200,000 on the contract. Before any work takes place, Aramis, who sells tables, approaches Athos. Although there are several chair factories in the area, only Athos's factory can make tables. If Athos will supply Aramis with 50,000 tables, Aramis will pay him \$40 per table. Athos can produce the tables for \$25, so he can make a net profit of \$750,000 if he uses his factory for Aramis's tables. But to do so, he must breach his contract with Porthos. There are other chair factories, and Porthos will be able to get the chairs from one of them—for example, from D'Artagnan's. Let us assume that because of his distress situation Porthos will have to pay D'Artagnan 20% more than Athos's price for comparable chairs, and that Porthos will sustain \$100,000 in incidental administrative costs and consequential costs such as damages for delay to his customers. Even with these costs, Porthos will lose only \$300,000 because of Athos's breach, and Athos can reimburse him in full and still make \$450,000 profit, over twice the profit from his contract with Porthos.<sup>156</sup>

As an aside, this example does not describe a "garden variety" sale of existing goods. Suppose that Aramis offered to buy the (completed) chairs which Athos has agreed to sell Porthos. In such a case, is Aramis willing to pay Athos a price higher than the market price? If he does not pay a higher price, under the damages formula based on the difference between Porthos's contract price and the market price, Athos will owe Porthos as much as he gains from Aramis. Moreover, if the market has risen a great deal, it would pay Aramis to deal with Porthos, who, because of the great rise, could sell slightly below market price and still make a profit. But then why would Porthos sell below market? Clearly something more than market forces would be involved. The reader may ask how often these unusual situations come along. Whatever the answer, the "efficient breach" doctrine has generated much discussion.

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neil, *Efficient Breach of Contract: Circles in the Sky*, 68 VA. L. REV. 947 (1982); Marschall, *Willfulness: A Crucial Factor in Choosing Remedies for Breach of Contract*, 24 ARIZ. L. REV. 733 (1982); and Schwartz, *The Case for Specific Performance*, 89 YALE L.J. 271 (1979).

156. Linzer, *supra* note 155, at 114-15 (footnotes omitted).

Under the rule that foreseeability is required at the time of the making of the contract, Danzig pointed out that a person in Athos' predicament has difficulty in making a sound decision on the results of the breach.<sup>157</sup> A sounder decision can be made nearer the time of performance or breach. The true loss to the party who will be injured by a breach will be, on the average, more apparent the closer in time to the intended breach one tries to predict that loss. Fresher data will be available—a knowledge of prices at a time closer to when performance would be due, for example. Difficulty in predicting the loss does not encourage breach. An intentional breach of a contract for the sale of goods, however, will not necessarily produce a benefit to society. From an economic standpoint, it must be argued that “it is difficult to identify circumstances in which breach, rather than performance will produce [more efficient use of resources].”<sup>158</sup>

The argument favoring intentional breach is based on economic considerations only. Since buyers and sellers enter commercial contracts to make money, and the damages under discussion here are monetary remedies, perhaps no other consideration should be entertained. However, other considerations do enter into one's views of a breach of contract. Parties enter into contracts, for example, because they place great store in reliability.<sup>159</sup> Buyers may not want to continue doing business with a seller who has been breaking promises whenever he thought it economically more profitable. (A reaction “His word is his bond—but for a buck!” is not a promising one.) Can injured parties be sure that they will *always* be adequately repaid for their loss? Will the injured party be content with what is offered with-

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157. R. DANZIG, *supra* note 5, at 104.

Resting the seller's liability on whether the type of damages incurred was “normal” (or, in the UCC's words, whether it was a type of damage of which the seller had “reason to know”), seems undesirable because it lets an all-or-nothing decision ride on an indicator about which many sellers cannot, at the time of breach, speculate with confidence. Further, if recoverability of a type of damages is established, a seller may often have no reasonable basis for determining the magnitude of the damages involved.

*Id.*

158. Schiro, *supra* note 41, at 1728; Farber, *supra* note 155 (pointing out the need to focus on the effect of transaction costs and imperfect information).

159. Linzer, *supra* note 155, at 112.

In this Article, “morality” stands for the idea that it is both fair and appropriate to hold people to promises that they freely made. This view is inspired both by a desire to protect the promisee's reasonable expectations and by a sense that personal liberty requires that people be able to bind themselves in a manner that will be enforced by the courts.

*Id.* (footnotes omitted).

out resorting to a lawsuit? To return to a thought expressed above, the inadequate protection given by the present rules for recovery of damages in breach of contract cases should be reason enough for the law to discourage any breach.<sup>160</sup> If the new deal with Aramis is so appealing, what is wrong with Athos' working out a mutual rescission of the contract with Porthos?

In addition, there are other values to be considered. An "efficient breach" runs counter to the concept of good faith.<sup>161</sup> Good faith is expected in the performance of sales contracts under the UCC.<sup>162</sup> Good faith is also expected under the C.I.S.G.<sup>163</sup> In the international sphere, McDougal and Bebr discuss the common demands of people to share basic values.<sup>164</sup> According to these authors, while one of these basic values is "wealth," another is "rectitude."<sup>165</sup> For some people around the world, *pacta sunt servanda* (agreements should be kept) refers to international contracts as well as international treaties.

Half a century ago in the United States, McCormick illustrated that when a breach was intentional, courts were more likely to find the loss "foreseeable."<sup>166</sup> In addition, recent decisions of arbitral tribunals indicate that those tribunals treat intentional

160. See *supra* note 58 and accompanying text.

161. This Article considers the notion of "efficient breach," concluding that it is faulty and that such breaches should not be encouraged by the courts' use of remedial principles that allow the willful breacher to profit from his breach. "Even if the theory were realistic, the values that support it are of less importance to society than the principle of good faith and fair dealing in the performance and enforcement of contracts." Marschall, *supra* note 155, at 734.

162. U.C.C. § 1-203 (1987) provides "[e]very contract or duty within this Act imposes an obligation of good faith in its performance or enforcement."

163. For the text of Article 7, see *supra* note 3.

164. McDougal & Bebr, *Human Rights in the United Nations*, 58 AM. J. INT'L L. 603-08 (1964).

165. *Id.* Their thesis is that people demand "freedom to choose standards of *rectitude* and responsibility, to explain life, the universe, and values, and to worship as may seem best." The "base value" of rectitude includes ideas of right and wrong, arising out of religion or not. Some people's belief that it is wrong to break a contract will be based on reasons other than those monetary. *Id.*

166. C. McCORMICK, *supra* note 70, at 574-75.

In determining whether to tighten or relax in a particular case the curb upon damages in contract cases, which they exert through the flexible concepts of "notice" and "reasonable contemplation," it seems probable that two factors, of which the rule itself takes no account, exert a deep influence: . . . Second, the degree of *fault* attaching to the defendant. . . . Evidence that our courts share the tendency to widen the liability of the deliberate contract breaker, as distinguished from one who has by misfortune or mistake failed to carry out his promise, is furnished by the instances where the courts in their opinions have called attention to the willfulness of the defendant. In the view of the present writer, this tendency is a wholesome one.

breaches rather strictly.<sup>167</sup>

Limiting effective notice to the time of the contracting will not always discourage breaches. For instance, a party may discover at the time he or she decides to breach that losses will be much greater than were "foreseeable" at the time of contracting. In such a case, a rule which focuses on the time of contracting will be less discouraging than one which focuses on the time of breach. Nevertheless, if the notice time in the C.I.S.G., like the rule in *Hadley*, discourages most intentional breaches, this author would argue that this is a good result.

(e). "Facts and Matter of Which He Then Knew or Ought to Have Known"

The expression in the UCC "had reason to know"<sup>168</sup> does the work of both the "facts . . . which he . . . ought to have known" and the "foresaw or ought to have foreseen" clauses in the C.I.S.G. illustrating an interrelationship between the two. Interpreting the words of Article 74 may involve the consideration of several sources of "knowledge" available to the breaching party at the time of the conclusion of the contract. From one source, the breaching party will have the knowledge that merchants in general have—if this knowledge can be expected of this particular merchant.<sup>169</sup> From another source, the breaching party may have the knowledge of possible consequences of a breach communicated by the other party to the contract.<sup>170</sup> This knowledge

167. Bulow, *supra* note 6, at 630 ("Depending on how outraged they become when examining a breach, such Panels can now be persuaded to award to the innocent party the savings and perhaps even the profits that the breaching party might otherwise have gained from its non-performance.").

168. U.C.C. § 2-715(2)(a) (1987). For the text of § 2-715(2)(a) see *infra* note 177.

169. Knapp, *supra* note 21, at 542.

The party in breach will be considered as knowing the facts and matters enabling him to foresee the consequences of the breach of contract if such knowledge generally flows from the experience of a merchant or, in other words, if such knowledge can in the given case be expected of him having regard to his experience as a merchant.

*Id.*

170. *Id.*

The party in breach will also be considered as having known the facts and matters enabling him to foresee the possible consequences of the breach, and therefore, as having foreseen them, whenever the other party to the contract has drawn his attention to such possible consequences in due time. Should a party at the time of the conclusion of the contract consider that breach of contract by the other party would cause exceptionally heavy losses or losses of an unnatural nature, he may make this known to the other party with the result that if such damages are actually suffered they may be recovered.

*Id.* Article 8 of the C.I.S.G. contains the rules for interpreting statements of the parties:

requirement presents the judge with no new problems. For in the past, guided by *Hadley* and deciding what is "contemplable" or "foreseeable," United States and British courts have accepted the reality that "the usual course of things" changes. Carriers today "contemplate" more than those in Baxendale's day. This increase in knowledge may be caused by advances in technology (carriers know more "things": air freight did not exist at the time of *Hadley*, nor did land transport machines driven by gasoline engines, nor did computers for transport of electronic information).<sup>171</sup> Modern business practices (and equipment), accounting methods, and the extensive communication of information make more knowledge available to both parties. This increased knowledge may make potential amounts of loss easier to compute.<sup>172</sup> A potential breacher today will have available a great deal more information about what can happen concerning the contract and hence "ought to know" a great many more facts than a potential breacher in the nineteenth century.

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(1) For the purposes of this Convention statements made by and other conduct of a party are to be interpreted according to his intent where the party knew or could not have been unaware what that intent was.

(2) If the preceding paragraph is not applicable, statements made by and other conduct of a party are to be interpreted according to the understanding that a reasonable person of the same kind as the other party would have had in the same circumstances.

(3) In determining the intent of a party or the understanding a reasonable person would have had due consideration is to be given to all relevant circumstances of the case including the negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties.

C.I.S.G., *supra* note 1, art. 8.

171. In *Dunn v. Bucknall Brothers*, [1902] 2 K.B. 614, for instance, in changing the rule for recovery for loss of a market on a voyage by sea, the court pointed out that since the decision in the case establishing the rule to the contrary [*The Parana*, [1877] 2 P.D. 118], the means of sea transport had improved so that the accomplishment of voyages of short duration was more certain. Hence different results should be foreseeable. In the United States, in *United States v. Middleton*, 3 F.2d 384, 393 (4th Cir. 1924), the judge pointed out that since steam had become a source of power, sea voyages could be calculated more certainly. Merchants made their calculations accordingly and shipowners could be expected to utilize this increased information.

172. *Vitex Mfg. v. Caribtex Corp.*, 377 F.2d 795, 799 (3d Cir. 1967) (discussing the inclusion of overhead expenses in determining lost profits and citing previous cases which had not allowed this inclusion). "Thus, where the contract is between businessmen familiar with commercial practices, as here, the breaching party should reasonably foresee that his breach will not only cause a loss of clear profit, but also a loss in that the profitability of other transactions will be reduced." *Id.*

## (f). "Consequences of breach"

## (1). Consequential damages for the seller

The sections of the UCC concerning the measurement of buyer's damages—for non-delivery or repudiation<sup>173</sup> and for breach of warranty<sup>174</sup>—also allow the damages provided for in section 2-715, entitled "Buyer's Incidental and Consequential Damages."<sup>175</sup> While section 2-715 does not define incidental

173. U.C.C. § 2-713 provides:

## Buyer's Damages for Non-Delivery or Repudiation

(1) Subject to the provisions of this Article with respect to proof of market price (Section 2-723), the measure of damages for non-delivery or repudiation by the seller is the difference between the market price at the time when the buyer learned of the breach and the contract price together with any incidental and consequential damages provided in this Article (Section 2-715), but less expenses saved in consequence of the seller's breach.

(2) Market price is to be determined as of the place for tender or, in cases of rejection after arrival or revocation of acceptance, as of the place of arrival.

U.C.C. § 2-713 (1987).

174. U.C.C. § 2-714 provides:

## Buyer's Damages for Breach in Regard to Accepted Goods.

(1) Where the buyer has accepted goods and given notification [§ 2-607(3)] he may recover as damages for any non-conformity of tender the loss resulting in the ordinary course of events from the seller's breach as determined in any manner which is reasonable.

(2) The measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount.

(3) In a proper case any incidental and consequential damages under the next section may also be recovered.

175. Other sections of the U.C.C. also allow for a buyer's damages. U.C.C. § 2-711 provides:

## Buyer's Remedies in General; Buyers Security Interest in Rejected Goods

(1) Where the seller fails to make delivery or repudiates or the buyer rightfully rejects or justifiably revokes acceptance then with respect to any goods involved, and with respect to the whole if the breach goes to the whole contract (Section 2-612), the buyer may cancel and whether or not he has done so may in addition to recovering so much of the price as has been paid

(a) "cover" and have damages under the next section as to all goods affected whether or not they have been identified to the contract; or

(b) recover damages for non-delivery as provided in this article (Section 2-713).

U.C.C. § 2-712 provides:

## "Cover"; Buyer's Procurement of Substitute Goods

(1) After a breach within the preceding section the buyer may "cover" by making in good faith and without unreasonable delay any reasonable purchase of or contract to purchase goods in substitution for those due from the seller.

(2) The buyer may recover from the seller as damages the difference between the cost of cover and the contract price together with any incidental or consequential damages as hereinafter defined (Section 2-715), but less expenses saved in consequence of the seller's breach.

(3) Failure of the buyer to effect cover within this section does not bar him from any other remedy.

damages or consequential damages,<sup>176</sup> it states what such damages include and lists some examples of those damages.<sup>177</sup> Under the UCC, consequential damages include "any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know," and (where there is breach of warranty) "injury to person" and "injury to property."<sup>178</sup> Article 5 of the C.I.S.G., which is more restrictive than the UCC, provides that the C.I.S.G. does not "apply to the liability of the seller for death or personal injury."<sup>179</sup> Thus, the international buyer will have to look to domestic law for recovery for death or personal injuries. Since the C.I.S.G. does not expressly exclude damages or injury to property, it may be open to question whether such coverage exists in those countries which classify such claims for damages as torts.<sup>180</sup>

In contrast to buyer's damages, sections 2-706, 2-708, and 2-709 of the UCC, covering a seller's damages, provide that the seller may recover incidental damages<sup>181</sup> (examples of these are

176. For extensive treatment of these two categories of damages, see Anderson, *Incidental and Consequential Damages*, 7 J. L. & COM. 327 (1987).

177. U.C.C. § 2-715 provides:

Buyer's Incidental and Consequential Damages.

(1) Incidental damages resulting from the seller's breach include expenses reasonably incurred in inspection, receipt, transportation and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with effecting cover and any other reasonable expense incident to the delay or other breach.

(2) Consequential damages resulting from the seller's breach include:

- (a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and
- (b) injury to person or property proximately resulting from any breach of warranty.

U.C.C. § 2-715 (1987).

178. *Id.* § 2-715(2).

179. C.I.S.G., *supra* note 1, art. 5.

180. Khoo, *Product Liability*, in C. BIANCA AND M. BONNELL, *supra* note 21, at 49-50.

181. U.C.C. § 2-706 in part provides:

Seller's Resale Including Contract for Resale.

(1) Under the conditions stated in Section 2-703 on seller's remedies, the seller may resell the goods concerned or the undelivered balance thereof. Where the resale is made in good faith and in a commercially reasonable manner the seller may recover the difference between the resale price and the contract price together with any incidental damages allowed under the provisions of the Article (Section 2-710) . . . .

U.C.C. § 2-708 in part provides:

Seller's Damages for Non-acceptance or Repudiation.

(1) Subject to subsection (2) and to the provisions of this Article with respect to proof of market price (Section 2-723), the measure of damages for non-acceptance or repudiation by the buyer is the difference between the market



provided),<sup>182</sup> but make no provision for the seller to recover consequential damages.<sup>183</sup>

In granting the right to recover consequential damages, Article 74 does not limit recovery to the buyer. What might consequential damages for the seller consist of? Of course, UCC Article 2, in not providing for a seller's consequential damages (as distinguished from expressly excluding such damages), could not be expected to answer that question. Under the C.I.S.G., however, such damages could include recovery for the type of loss similar to that for which the buyer currently recovers consequential damages. For instance, suppose the buyer expects to sell for a profit the goods he contracts to purchase. If a breach occurs, the buyer should try to avoid loss.<sup>184</sup> But when there is no delivery and the buyer cannot avoid the consequences by covering with substitute goods, the buyer would sue for profits lost. Similarly, suppose the seller expects to do things with the money paid for the goods. If the buyer fails to pay, the seller should try to avoid the loss.<sup>185</sup>

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price at the time and place for tender and the unpaid contract price together with any incidental damages provided in this Article (Section 2-710), but less expenses saved in consequence of the buyer's breach.

(2) If the measure of damages provided in subsection (1) is inadequate to put the seller in as good a position as performance would have done then the measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance by the buyer, together with any incidental damages provided in this Article (Section 2-710) . . . .

U.C.C. § 2-709 in part provides:

Action for the Price.

(1) When the buyer fails to pay the price as it becomes due the seller may recover, together with any incidental damages under the next section . . . .

182. U.C.C. § 2-710 provides that "[i]ncidental damages to an aggrieved seller include any commercially reasonable charges, expenses or commissions incurred in stopping delivery, in the transportation, care and custody of goods after the buyer's breach, in connection with return or resale of the goods or otherwise resulting from the breach."

183. U.C.C. § 1-106(1) (1987). Added to any argument that consequential damages for the seller are excluded by implication is the provision in U.C.C. § 1-106(1) that "neither consequential or special nor penal damages may be had except as specifically provided in this Act or by other rule of law." *Id.*; *Afram Export Corp. v. Metallurgiki Halyps, S.A.*, 772 F.2d 1358, 1368 (7th Cir. 1985); *Nobs Chem., U.S.A., Inc. v. Koppers Co.*, 616 F.2d 212, 216 (5th Cir. 1980). For a discussion that these arguments are not obviously correct, see J. WHITE & R. SUMMER, *supra* note 5, at 338-40.

184. Under Article 77 of the C.I.S.G., the injured party, whether the buyer or the seller, should mitigate damages:

A party who relies on a breach of contract must take such measures as are reasonable in the circumstances to mitigate the loss, including loss of profit, resulting from the breach. If he fails to take such measures, the party in breach may claim a reduction in the damages in the amount by which the loss should have been mitigated.

C.I.S.G., *supra* note 1 art. 77.

185. *Id.*

Still, the seller may suffer a loss when there is a failure of payment because the seller can not use the money as expected and the seller can not avoid the consequences of that loss either by selling the goods or borrowing. The seller should be able to recover for that loss.<sup>186</sup>

If consequential damages are allowed, sellers' recoveries will probably be different than either buyers' or borrowers' (in breaches of contract to lend money). It should be easier, as a rule, for a seller to borrow substitute money (which is theoretically always available for a price) than for a buyer to purchase substitute goods (which are not always available); accordingly, fewer claims should be expected by sellers for the expense of obtaining the substitute (interest). Also, borrowers generally specify the intended uses of loans. It follows from the notice of a specific use to the lender that foreseeability is more probable in the case of lenders than it is in the case of a buyer in a sale (who is not told what the seller will do with the money).

## (2). Incidental Damages

The UCC does not permit the seller to recover "consequential" as well as "incidental" damages. The Restatement permits the seller to recover both.<sup>187</sup> But why are two different words and two different categories of damages necessary? Are incidental damages not a consequence of the breach and are consequential damages not an incident of the breach? Textwriters treated a Louisiana case decided before *Hadley* as illustrating the

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186. This situation raises a question concerning the necessity of a resale to prevent a loss. Consider the case of a buyer's breach followed by the seller's resale of the goods to another. Assume that the contract price was \$100,000 and the resale price is \$90,000. The resale will not put the seller in the same position as performance of the contract. In the correlative situation, the buyer (who failed to receive goods because of a breach) in purchasing substitute goods will supposedly purchase the same amount of goods and thus have the same quantity as if the contract had been performed. If the substitute contract costs the buyer more and the buyer does not have this extra amount, presumably the buyer will borrow the difference. For the seller in the hypothetical to obtain the additional \$10,000, and avoid the consequential damages that the seller would otherwise suffer, the seller with an inventory adequate to do so might make a contract to sell an extra one-ninth of the total goods. Must the seller do so? The seller's coming forth with more goods would be similar to the buyer coming forth with more money for the substitute purchase. But surely a court would consider it an equally acceptable way of avoiding the consequences of the loss if the seller borrowed \$10,000, unless the cost of the loan was significantly more than the total cost of selling the extra one-ninth of the total goods.

187. RESTATEMENT (SECOND) OF CONTRACTS § 347(b) (1979), provides for recovery of damages measured by "any other loss, including incidental or consequential loss, caused by the breach."

interchangeability of these words.<sup>188</sup> Based on a provision of the Louisiana Civil Code, the case used the term “incidental” to mean “consequential” damages.<sup>189</sup> The plaintiff sought to recover for the value of his law practice, lost when he went to work on a plantation of the defendant (his father-in-law) under a contract which the plaintiff claimed his father-in-law had breached. The Louisiana Supreme Court reasoned that under the Louisiana Code, “[t]he damages which a party can recover on a breach of a contract, are those which are *incidental* to and caused by the breach; and may reasonably be supposed to have entered into the contemplation of the parties at the time of the contract.”<sup>190</sup> Despite the plain language used by the court, two treatises later interpreted this case as involving *consequential* damages.<sup>191</sup>

Perhaps the term “incidental”<sup>192</sup> was chosen and those damages distinguished from “consequential” damages because the former do not have to be proved foreseeable to allow recovery. The New York Law Revision Commission, when considering the adoption of the UCC, concluded that section 2-710 (the seller’s incidental damages) indicated the source of the right to inciden-

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188. *Williams v. Barton*, 13 La. 404, 410 (1839) (citing Louisiana Civil Code of 1928 art. 161).

189. *Id.* For a similar use of “incidental,” see *Hamilton v. McPherson*, 28 N.Y. 72 (1863).

190. *Williams v. Barton*, 13 La. at 410 (emphasis added).

191. T. SEDGWICK, *MEASURE OF DAMAGES* 67 (2d ed. 1852); J. SUTHERLAND, *DAMAGES* § 45, at 135 (3d ed. 1903).

192. There does not seem to be a connection between the word “incidental” as used here and as used by Professor Fuller in the “incidental reliance interest.” In his article, Fuller uses the term “incidental” reliance in referring to expenses in connection with certain acts following from the contract. The acts are not necessary to perfect the plaintiff’s rights on the contract. Fuller contrasts the word “incidental” with “essential,” which refers to expenses that the plaintiff must incur to prepare and to perform the contract. If the reliance is “essential,” the damages will usually be “natural”; if it is “incidental,” notice may be required. See Fuller & Perdue, *supra* note 74, at 87-88.

For example, the plaintiff enters into a contract to purchase a machine used to make products. The plaintiff spends money building a foundation that will be needed to support the machine. Loss of this money resulting from a breach of contract would fall within the “incidental reliance” category rather than the “essential reliance” category because the plaintiff does not have to spend this money to perform the duty (perfecting his or her rights) under the contract, since the only duty is to pay for the machine. The plaintiff may seek to recover the costs of building the foundation if the seller of the machine breaks the contract, so long as the plaintiff meets certain requirements. Here “incidental” goes with the requirement of notice. Yet the *NEW YORK REPORT*, *supra* note 78, at 701, associates “incidental” damages as those not requiring notice.

For a case involving Fuller’s “incidental reliance”, see *L. Albert & Son v. Armstrong Rubber Co.*, 178 F.2d 182 (2d Cir. 1949).

tal damages is the "first branch" of the rule of *Hadley v. Baxendale*.<sup>193</sup> This interpretation would mean that "incidental" damages are those that "arise naturally" and are those damages which the defendant would be bound to foresee. Such an interpretation does not, however, completely distinguish "incidental" from "consequential" damages since some of the "consequential" damages, like injury to person or property, are bound to be foreseen (if they proximately result)<sup>194</sup> and other damages also "arise naturally."<sup>195</sup>

Modern courts also have difficulty distinguishing incidental and consequential damages. One example appeared in a case involving unsuitable oil that damaged machinery in a sawmill.<sup>196</sup> The Eighth Circuit Court of Appeals allowed, as "incidental" damages, the recovery of "costs incurred in the repair and replacement of mechanical parts damaged by the oil's failure to function properly."<sup>197</sup> But these damages could also be listed as property damages under the consequential damages classification.<sup>198</sup> The result is that "[t]he line between incidental and consequential damages is rather unclear."<sup>199</sup> However, this

193. NEW YORK REPORT, *supra* note 78, at 696. These damages could be implied from N.Y. Personal Property Law § 145(2) which used the expression "loss directly and naturally resulting." The Report states that "[t]he terms 'directly and naturally' presumably refer to the 'first branch' of the rule" and therefore need not satisfy the "contemplation" test. *Id.*; see also *Gray v. West*, 608 S.W.2d 771, 781 (Tex. Ct. App. 1980) (holding that the common law rule (*Hadley 2*) requiring that the damages be in contemplation of the parties does not apply to incidental as distinguished from consequential damages).

194. U.C.C. § 2-715(2)(b) (1987).

195. These damages are included in the "general requirements" language of U.C.C. § 2-715(2). J. WHITE & R. SUMMERS, *supra* note 5, at 446 n.21.

196. *Lewis v. Mobil Oil Corp.*, 438 F.2d 500 (8th Cir. 1971).

197. *Id.* at 507.

198. White and Summers agree as to the "consequential damages" characterization in such cases (but do not add the classification "property damages"). J. WHITE & R. SUMMERS, *supra* note 5, at 44 n.15.

199. *Afram Export Corp. v. Metallurgiki Halyps, S.A.*, 772 F.2d 1358, 1369 (7th Cir. 1985). Following this quote in the text of the opinion, the court suggested a test: if the expense or loss could have been avoided by greater prudence on the victim's part, damages sought to repay the loss are consequential. The court concluded that interest that the victim (seller) paid to finance cars from which scrap metal was derived should be classified as incidental damages. *Id.*

Another suggestion is found in *Petroleo Brasileiro, S.A. Petrobras v. Ameropan Oil Corp.*, 372 F. Supp. 503, 508 (E.D.N.Y. 1974), in which the distinction is made that incidental damages are normally incurred when a buyer (or seller) repudiates the contract or wrongfully rejects the goods, causing the other to incur . . . expenses, . . . [while] consequential damages . . . [usually arise] from losses incurred by the non-breaching party in its dealings, often with third parties, which were a proximate result of the breach.

*Id.*

confusion should not be interpreted as an argument that under the UCC a seller may successfully sue for consequential damages by claiming that such damages are the same as incidental damages.

Article 74 of the C.I.S.G., which is more comprehensive than the related UCC sections, provides for damages for loss suffered "as a consequence of the breach" for both the buyer and the seller. These damages are labeled neither "consequential" nor "incidental."<sup>200</sup> Nevertheless, what the UCC calls "incidental" damages seems to be included within the scope of Article 74. Under the Restatement, terminology is not controlling<sup>201</sup> and this may be the accepted view of the drafters of Article 74. Nothing in the Article indicates an intent to abolish those types of damages which the UCC labels "incidental."

(g). "Such damages may not exceed"

(1). The "Harsh" Cases

While it is encouraging to see broader protection for the injured party, limiting the liability of the breaching party also may be desirable under some circumstances.<sup>202</sup> In considering ways to limit the liability of the breaching party under Article 74,

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200. It is not certain that there was an intent by the drafters of the UCC to make these words in the UCC terms of art. But the words "incidental" and "consequential" are more than casual adjectives applied to the damages in § 2-715, for the caption is "Buyer's Incidental and Consequential Damages." U.C.C. § 2-715 (1987). U.C.C. § 1-109 states that "[s]ection captions are parts of this Act."

There is no similar word such as "general" or "direct" describing the damages found in the sections for the seller's damages for non-acceptance or repudiation or for the buyer's damages for non-delivery and repudiation. Nor are such words used when referring a reader from one section to another. For instance, § 2-711(1) simply provides that a buyer can "cover" and (referring to "general" damages) "have damages under the next section." Similarly § 2-714(3) could have provided for the buyer to recover "any damages under the next section" without adding more. But it contains the words "incidental and consequential."

201. RESTATEMENT (SECOND) OF CONTRACTS § 347 comment c (1979).

Items of loss other than loss in value of the other party's performance are often characterized as incidental or consequential. Incidental losses include costs incurred in a reasonable effort, whether successful or not, to avoid loss, as where a party pays brokerage fees in arranging or attempting to arrange a substitute transaction . . . . Consequential losses include such items as injury to person or property resulting from defective performance . . . . The terms used to describe the type of loss are not, however, controlling, and the general principle is that all losses, however described, are recoverable.

*Id.*

202. See A. FARNSWORTH, *supra* note 78, § 12.17, at 891-92.

Sometimes a court is confronted with a large damage claim that seems greatly disproportionate to the modest consideration received by the party in breach. It may not seem just to require the party in breach to pay for all the loss that

observe that the article provides that "damages may not exceed the loss. . ." and does not add "or be less than the amount proved."<sup>203</sup> The chosen words of Article 74 allow for leniency toward the breaching party in the "harsh" case.<sup>204</sup> Leniency under the C.I.S.G. is in accord with the principle stated by Professor Fuller: "it is not always wise to make the defaulting promisor pay for all the damage which follows as a consequence of his breach."<sup>205</sup> Arguably, the most important factor in determining whether the award would be "harsh," is the relationship between the consequential damages sought and the amount paid to the party in breach of the contract. Treitel contrasts *Hadley* and *The Heron II* on this basis.<sup>206</sup> Unfortunately, cases following *Hadley* do not always handle the matter well.

#### (A). *The "Tacit Agreement" Rule*

The development of the "tacit agreement" rule<sup>207</sup> provides an example of poor handling of the "harsh case" problem. The "tacit agreement" rule derives from *British Columbia Saw-Mill Co. v. Nettleship*,<sup>208</sup> a case involving loss of machinery during carriage.<sup>209</sup> Sir James Shaw Willes,<sup>210</sup> the gentleman who previously

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he has caused, even though it was foreseeable and has been proved with reasonable certainty.

*Id.*

203. See C.I.S.G., *supra* note 1, art. 74.

204. Hopefully this leniency will not lead to an interpretation which would unduly limit the injured party's possibility of recovery. Such an outlook was expressed about 60 years ago in an English article which said,

[b]efore *Hadley's Case*, it was said that 'where a party sustains a loss by reason of breach of contract, he is, so far as money can do it, to be placed in the same situation, with respect to damages, as if the contract had been performed.'

Though at one time fully accepted, this has become one of those generous aspirations which the law *does well to put but sparingly into practice*.

Washington, *Damages in Contract at Common Law*, 48 LAW Q. REV. 90, 107 (1932) (emphasis added).

205. Fuller & Perdue, *supra* note 74, at 84.

206. G. TREITEL, *supra* note 135, at 178. In *Hadley v. Baxendale*, 156 Eng. Rep. 145 (Ex. 1854), the loss of profits was 20 times the amount the carrier received for hauling the shaft. In *The Heron II*, [1969] 1 App. Cas. 350, the loss of profits was less than half the freight paid the carrier.

207. Those who have thought that this rule was a thing of the past were probably surprised to see it revived by Judge Posner in *Evra Corp. v. Swiss Bank Corp.*, 673 F.2d 951 (7th Cir.), *cert. denied*, 459 U.S. 1017 (1982).

208. *British Columbia Saw-Mill Co. v. Nettleship*, [1868] 3 L.R.-C.P. 499.

209. The defendants contracted to carry to Canada machinery to erect a sawmill. Part of the machinery was lost on the way and the mill could not be built until substitute pieces were sent from England. The plaintiff recovered only the cost of the substitute pieces plus interest. *Id.*

210. For more on this gentleman, see R. DANZIG, *supra* note 5, at 83, 97-98. Sir

had been counsel for Mr. Baxendale in *Hadley* and had been elevated to the bench, wrote the opinion in *Nettleship*. Perhaps Sir James did not believe that the *Hadley* rule adequately protected the breaching carrier, for he constructed another hurdle for the injured party to surmount before recovery. Contemplation of the damages was not enough. Recovery was further limited by the court's assertion that "the mere fact of knowledge cannot increase the liability [beyond actual damages]. The knowledge must be brought home to the party sought to be charged under such circumstances that he must know that the person he contracts with reasonably believes that he accepts the contract with the special condition attached to it"<sup>211</sup>—that is, inquiry into the subjective thoughts of the breaching party at the time of contracting.

The "tacit agreement" rule was adopted in the United States in *Globe Refining Co. v. Landa Cotton Oil Co.*,<sup>212</sup> an opinion by Mr. Justice Holmes.<sup>213</sup> The case involved a contract for the sale of cottonseed oil between a firm in Texas and a firm in Kentucky. Holmes addressed the question of whether the allegations of special damages in the pleadings justified a recovery of damages over and above the difference between the contract price of the oil and the market price at the time of the breach.<sup>214</sup> The Court held that they did not. The Court based its finding on the "tacit agreement" rule, stating: "[W]hat the plaintiff would have been entitled to recover . . . depends on what liability the defendant fairly may be supposed to have assumed consciously, or to have warranted the plaintiff reasonably to suppose that it assumed,

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James also later wrote an opinion in *Horne v. Midland Ry.*, 7 L.R.-C.P. 583, 591 (1872), using the "tacit agreement" rule again.

211. *Nettleship*, 3 L.R.-C.P. at 509.

212. *Globe Ref. Co. v. Landa Cotton Oil Co.*, 190 U.S. 540 (1903).

213. One commentator has said about Justice Holmes's opinion: "[His] *Globe Refining* opinion started out after the mirage of 'perfect compensation, not a penny more,' and came out with as harsh a result as could a commercial woodenhead." K. LLEWELLYN, *THE COMMON LAW TRADITION DECIDING APPEALS* 188 (1960).

214. The buyer sent railroad cars to carry the oil from the Texas mill to another destination. When the seller breached the contract, the plaintiff brought suit in federal court. Among the consequential damages sought were the costs of sending the cars. If those damages could not be recovered, the federal court did not have jurisdiction. *Globe Refining*, 190 U.S. at 540. In 1903, when the *Globe Refining* case was decided, the matter in dispute had to exceed \$2,000 to confer jurisdiction on the (federal) Circuit Court. Judiciary Act of Aug. 13, 1888, ch. 866, 25 Stat. 433 (current version at 28 U.S.C. § 1332 (1988)).

It is possible to read into the case a struggle by a straw-grabbing plaintiff who gets out of the state court and into federal court only to be met by a determined Holmes, who sends him back.

when the contract was made.”<sup>215</sup> The “or” clause of this statement should have adequately protected the plaintiff (injured party) in his expectation, because the plaintiff’s supposition as to what the defendant assumed would need only to be “reasonable.” Despite this quote the Court gave added protection to the defendant, agreeing that “he must know” that the plaintiff “reasonably believes that he accepts” the responsibility for consequential damages or as Willes said, “the contract with the special condition.”<sup>216</sup> The defendant’s acceptance or rejection of responsibility for consequential damages is tacit in that the defendant does not have to tell the plaintiff whether or not the defendant “knows” that the plaintiff “reasonably believes that he [the defendant] accepts” the responsibility. The reader is never told how a finder of fact determines that the defendant “knows” that the plaintiff “reasonably believes” the defendant’s acceptance. Nor is one told why, if the plaintiff’s belief is “reasonable,” the defendant is not bound to know what the belief is.

Assume that the *Hadley* rule reflects what actually happens during contracting. Perhaps Willes and Holmes meant for the rule to apply to special types of Hadley 2 situations (Once a case is a Hadley 1, recovery should be automatic). Willes and Holmes may have meant to classify any case to which they intended to apply the “tacit agreement” rule as a Hadley 2 case—even if it appeared to some people to be a Hadley 1. The type of Hadley 2 case called for would be either one in which contemplation was to be based on knowledge obtained other than by express notice,<sup>217</sup> or one in which even if a notice had been given, that notice could be cancelled out as “indefinite” or “inadequate.”<sup>218</sup>

215. *Globe Refining*, 190 U.S. at 544.

216. See *supra* note 208.

217. Examples are two cases mentioned by Bauer:

Courts have found difficulty in the following types of cases: (1) where reasonable men may differ on the question whether, at the time of making the contract, there was an inherent general probability that damage of the type in question would occur as a result of such breach by defendant; [and] (2) where reasonable men may differ on the question whether the facts operated to give defendant knowledge, at the time of making the contract, that there was a special probability that damage of the type in question would occur as a result of such a breach.

Bauer, *Consequential Damages in Contract*, 80 U. PA. L. REV. 687, 702 (1932). If one prefers the approach that there are three Hadley Rules, one would classify this “contemplation” as being governed by the “second rule.” See *supra* notes 81-84 and accompanying text.

218. For example, the *Hadley* Court said that although the carrier had been told the intended use of the shaft and that the mill was shut down, the carrier had not been given the further information that another shaft was not available. Thus, notice was not sufficient. Commenting on this technique, Dean McCormick said:



Once the facts had been interpreted to show such a situation, contemplation would be based on "experience" (or "common sense" or some similar bases that would avoid testimony as to what the business community considered contemptible under the circumstances). It would be necessary to avoid outside evidence as to what the defendant ought to have contemplated. The judge could then determine what was contemplated. The result would be reached not because the defendant tacitly rejected the obligation, but because the defendant did not consider the risk and, therefore, could not tacitly assume the risk. If that is the desired result, however, would it not be just as easy to say that the risk was "not in the contemplation of the defendant" and base the decision on *Hadley* without the added rule?

In any event, if the risk in fact was contemplated by the defendant, what about the case in which the plaintiff reasonably thought that the defendant, by saying nothing about the risk (in the defendant's "tacit" non-acceptance), had accepted the liability? Should the defendant be relieved of liability because of no acceptance? Surely Holmes did not approve this situation. There is no place in contract law for secret renunciations of duties that objectively appear to have been assumed,<sup>219</sup> nor was there such a rule at the time Mr. Justice Holmes was on the Supreme Judicial Court of Massachusetts.<sup>220</sup> In such a case, the defendant should express reservations.

Assume that *Hadley* does not reflect what happens during contracting. Consider it a fiction, just a rule serving to control juries

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Usually the deficiency thus . . . found in the establishment of the element of notice, in cases where the defendant concededly had ample knowledge of the special purpose of the contract, is the failure to show that the defendant had knowledge that the plaintiff could not attain this purpose and avoid the special loss, by securing the same service which the defendant has promised from other sources.

C. McCORMICK, *supra* note 70, at 573.

219. RESTATEMENT (SECOND) OF CONTRACTS § 20 (1979). This conclusion is in accord with the statement on misunderstanding found in *Restatement* § 20:

- (2) The manifestations of the parties are operative in accordance with the meaning attached to them by one of the parties if
- (a) that party does not know of any different meaning attached by the other, and the other knows the meaning attached by the first party.

*Id.*

220. Concerning why a defendant was liable to pay for insurance premiums: "[I]f the jury found that . . . the plaintiff believed, and had reason to believe, that he [the defendant] did assent to it, his [the defendant's] secret intention not to do so was immaterial." *Bohn Mfg. Co v. Sawyer*, 48 N.E. 620, 621, 169 Mass. 477, 477 (1897). The opinion was written by another justice, but Holmes did not dissent or concur in a separate opinion so as to show a different view.

who otherwise might award too much money.<sup>221</sup> Taken as a mental exercise, one must begin with a concept—whether a fact was contemplable (or later “foreseeable”) and in some cases perhaps actually contemplated (“foreseen”). Then, to that concept, one must overlay the possible-though-not-objectively-manifested workings of a defendant’s mind in assenting or not. One works with a double fiction,<sup>222</sup> which surely is a waste of time.

Controlling a jury in such a case may seldom be a problem today. At the time *Hadley* was decided, juries were not always used in civil cases,<sup>223</sup> and juries are used even less today. Juries are not expected to play a significant role in cases for breach of international contracts for sales. So the rule (or rules) of the case which has served to restrain juries, now serves as a statement in the opinion by judges giving reasons for the results.<sup>224</sup> If the judge is acting alone, that judge should not need the added test. The rule of *Hadley v. Baxendale* has as its goal that the damages awarded will be fair and just.<sup>225</sup> A judge who thinks that the damages claimed do not fit this criterion can justify a ruling with the single tool, “not in the contemplation of the parties” or “not foreseeable”, as most of the judges do now.

This needless rule was eventually rejected in England<sup>226</sup> (though some argued that this was only a recent rejection);<sup>227</sup>

221. C. McCORMICK, *supra* note 70, at 565, 574; R. DANZIG, *supra* note 5, at 94-95.

222. In both the *Nettleship* and *Horne* cases, insufficiency of the carrier’s knowledge could have been the basis for the result using the *Hadley* rule without more. The new rule added the fiction of a tacit promise to the original fiction of “contemplation.” As Williston put it, “The fiction here criticized is a manifestation of the broader fiction that the parties contract for whatever obligations or consequences the law may impose upon them.” 11 WILLISTON ON CONTRACTS § 1357 (1957).

223. R. DANZIG, *supra* note 5, at 95.

224. In *The Heron II*, [1969] 1 App. Cas. 350, 414, Lord Pearce colorfully put it that “the lucubrations of judges who have to give reasons superseded the reticence of juries.”

225. What is fair and just depends on one’s approach, of course. Compare the principle as stated by Fuller & Perdue, *supra* note 74 and accompanying text, with that of Judge Posner: “[T]he animating principle of *Hadley v. Baxendale*, . . . is that the costs of the untoward consequence of a course of dealing should be borne by that party who was able to avert the consequence at least cost failed to do so.” *Evra Corp. v. Swiss Bank Corp.*, 673 F.2d 951, 957 (7th Cir.), *cert. denied*, 459 U.S. 1017 (1982).

226. A. GUEST, *ANSON’S LAW OF CONTRACT* 564 (25th ed. 1979); C. McCORMICK, *supra* note 70, at 576-77; Smith, *supra* note 29, at 285.

227. P. ATIYAH, *THE RISE AND FALL OF FREEDOM OF CONTRACT* 434 (1979). “[T]he *British Columbia Saw Mill* case and the *Horne* case represented the high-water mark of the bargain approach which placed such severe limits on the damages recoverable . . . The culmination of this process was not reached until recent years; indeed, it was only with the decision of the House of Lords in *Czarnikow v. Koufos Ltd. (The Heron II)*, in 1969 that

and though adopted by the United States after that,<sup>228</sup> the rule was also rejected by most,<sup>229</sup> but unfortunately not all,<sup>230</sup> U.S. jurisdictions. *Evra Corporation v. Swiss Bank Corporation*<sup>231</sup> was a suit for negligent handling of a transfer of funds by telex to pay for the charter of a ship. As a result, to get the use of a substitute ship, the plaintiff had to pay the double rate provided for in its original contract. The United States Court of Appeals for the Seventh Circuit denied recovery for losses sustained thereby. This was only a few years after England in *The Heron II* disapproved "foreseeable" because it applied to tort damages, which were easier to recover than those under the *Hadley* rule. *Evra*, on the other hand, relying on *Hadley* and *Globe*, added to the difficulty of recovering damages for a tort.

One might ask why the concern since *Evra* involved the rendition of services and not the sale of goods. In fact, *Evra* was considered a tort case and not a breach of contract case since the plaintiff had no contractual relationship with the defendant. The answer is that it is disturbing to see *Globe* being used again to back up denial of recovery. The case is like the vampire from the 1930s "sequel" movies. One may think it dead, but it continues to reappear to drain the lifeblood from what might have been a good case for recovery, and its sole purpose on earth has been to see that the injured party cannot recover.<sup>232</sup> Standing alone, it hides the reason behind a fiction and gives little guidance for

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it was reached, and that (in effect) these two leading nineteenth-century cases were discarded." *Id.*

228. Interestingly, in *Globe Refining*, Holmes mentions Bramwell's suggestion in *Gee v. Lancashire & Yorkshire Ry.*, 158 Eng. Rep. 87, 91 (Ex. 1860), that perhaps notice between the time of contracting and breach would be enough and adds that it "is not accepted by the later decisions." *Globe Ref. Co. v. Landa Cotton Oil Co.*, 190 U.S. 540, 544 (1903). But when Holmes cites Willes's "tacit agreement" rule used in the *Nettleship* case, the Justice does not point out that it is not accepted in later decisions and was not the law in England at the time of the *Globe* decision. *Globe* is a 1903 case, later than Smith's 1900 article, *supra* note 29, pointing out the rejection.

229. C. McCORMICK, *supra* note 70, at 579 (noting the rejection of the doctrine in most state jurisdictions); D. DOBBS, *REMEDIES* 805 (1973); J. WHITE & R. SUMMERS, *supra* note 5, at 445; *see also* U.C.C. § 2-715 comment 2 (1987) (stating that "[t]he 'tacit agreement' test for the recovery of consequential damages is rejected"); *RESTATEMENT (SECOND) OF CONTRACTS* § 351 comment a (1979) (rejecting the "tacit agreement" rule).

230. *Morrow v. First Nat'l Bank of Hot Springs*, 261 Ark. 568, 550 S.W.2d 429 (1977). In Pennsylvania, the "tacit agreement" rule had even been applied to a sale of goods contract in *Keystone Diesel Engine Co. v. Irwin*, 411 Pa. 222, 191 A.2d 376 (1963). A later Pennsylvania court, however, declined to follow *Keystone*. *R.I. Lampus Co. v. Neville Cement Products Corp.*, 474 Pa. 199, 378 A.2d 288 (1977).

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

232. Referring to *Globe Ref. Co. v. Landa Cotton Oil Co.*, 190 U.S. 540 (1903),

future cases. Such a convoluted rule is particularly inappropriate for an international sales case. A simpler approach is more likely to be uniformly (or harmoniously) followed in courts of different legal systems.

(B). *The "Foreseeable" Rule*

Having rejected the tacit agreement rule, courts now have a practice of limiting recovery in the "harsh" case solely by saying that the damages were not "foreseeable." This practice changes the meaning of "foreseeable" so that losses are "unforeseeable" not as a matter of fact, but as a matter of fact and law. While this practice is less involved than the tacit agreement rule was, the real reason for the damages not being "foreseeable" should be stated.<sup>233</sup> The technique need not be resorted to under the C.I.S.G. since the wording of Article 74 permits a court to limit recovery even though the damages in some cases are foreseeable.<sup>234</sup>

Article 74 provides no guidelines for such cases, and this problem will not be one of the easier ones for a court. Once a court determines that Article 74 does not guarantee that damages may be recovered in the amount proved, only that this amount is the upper limit, the court then may be compelled to state why it reaches the result that it does. The court must find a basis for the statement that the amount allowed to be recovered is less than

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Dean McCormick said, "[t]he opinion seems almost perverse in its anxiety to make all intendments against the pleader." C. MCCORMICK, *supra* note 70, at 579.

233. A. FARNSWORTH, *supra* note 78, at 892-93.

[T]he tacit agreement test has now generally been discarded and no longer affords a vehicle for limiting recovery in such cases.

Nevertheless, there remains a judicial reluctance to impose on a contracting party liability in an amount greatly disproportionate to the consideration that he received. . . . Courts have covertly expressed their reluctance by so applying the test of foreseeability as to find that what was foreseeable becomes "unforeseeable." They have also shown their reluctance by a particularly rigorous application of the requirement of certainty. Use of the requirements of foreseeability and certainty as surrogates for some other principle, however, has not contributed to clarity in dealing with this problem. What is the principle for which these limitations are surrogates?

*Id.*

234. See C.I.S.G., *supra* note 1, art. 74. Professor Farnsworth earlier made a case for a solution such as this:

A more satisfactory solution would be to preserve the test of foreseeability as the outer limit of liability in contract, but to recognize a judicial prerogative to further reduce that liability in light of a convincing showing that although the consequences were foreseen, or at least foreseeable, the risk was *not* assumed by the promisor.

Farnsworth, *Legal Remedies for Breach of Contract*, 70 COLUM. L. REV. 1145, 1209 (1970).

the amount foreseeable. One possible solution is for the court to indicate that the award is an amount that the court thinks is more nearly proportionate to the payment which the breaching party received. The advantage of this technique is that it provides a simple rule and one that *can* be used to reflect legal and cultural values in the United States and those of people in other legal systems. The disadvantage of this solution is that if a court does not examine the results of cases or writings in treatises from other systems, the court will not be certain that the decision *does* reflect the values of others. Due to the simple statement of the rule in Article 74, development will have to come through judge-made law and all judges may not weigh the proportion of payment to liability in a similar manner. A court handling such cases will want to observe decisions of both local and foreign courts so that there may be harmonization of results.

(C). *The Restatement*

While it is strongly discouraged,<sup>235</sup> some U.S. judges may be tempted to seek "general" principles in U.S. contract law by turning to the Restatement, since it contains a section limiting consequential damages.

Perhaps because of dissatisfaction with the way in which the "harsh" cases were disposed, some authorities in the field of contracts sought a more equitable solution. The Restatement section 351<sup>236</sup> limits the recovery of consequential damages to those

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235. Eorsi, *General Provisions*, in N. GALSTON AND H. SMIT, *INTERNATIONAL SALES: THE UNITED NATIONS CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS* § 2.04, at 2-12 (1984).

But the real danger to unification is that in the search for general principles it is unlikely that the tribunals and parties would find the same "general principles." And if different jurisdictions find different general principles or interpret them in a different way, possibly following local practice, then unification will suffer a heavy blow.

*Id.*

236. RESTATEMENT (SECOND) OF CONTRACTS § 351 (1979) provides:

Unforeseeability and Related Limitations on Damages.

(1) Damages are not recoverable for loss that the party in breach did not have reason to foresee as a probable result of the breach when the contract was made.

(2) Loss may be foreseeable as a probable result of a breach because it follows from the breach

(a) in the ordinary course of events, or

(b) as a result of special circumstances, beyond the ordinary course of events, that the party in breach had reason to know.

(3) A court may limit damages for foreseeable loss by excluding recovery for loss of profits, by allowing recovery only for loss incurred in reliance, or otherwise if it concludes that in the circumstances justice so requires in order to avoid disproportionate compensation.

that the party in breach had reason to foresee at the time that the contract was made. But subsection (3) is new,<sup>237</sup> presently a novel idea, which allows the court to limit damages "for foreseeable loss" if it concludes "that in the circumstances justice so requires in order to avoid disproportionate compensation."<sup>238</sup> The subsection refers specifically to excluding loss of profits and to limiting recovery to reliance losses. But the subsection also covers a wider area with "or otherwise." This varies from the *Hadley* rule and it has been suggested that the limitation may have been a reaction to "excessive recoveries that occurred in an expanding, inflationary economy."<sup>239</sup> This limitation goes beyond case law.<sup>240</sup>

One situation which could be covered by the "or otherwise" reference in the new subsection is where the buyer is in a superior economic position and can bear the financial risk better than the seller. Such a position has been described by Professor Stone in both an article and a legislative proposal concerning the liability for consequential damages of a supplier of a component part of an automobile when the automobile is recalled.<sup>241</sup> Stone lists

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Recovery of consequential damages under U.C.C. § 2-715(2)(a) is limited to those "which could not reasonably be prevented by cover or otherwise." U.C.C. § 2-715(2)(a) (1987). For the full text of § 2-715 see *supra* note 177. Unlike RESTATEMENT § 351, § 350(1) provides for avoidability as a limitation on damages.

Avoidability as a Limitation on Damages.

(1) Except as stated in Subsection (2), damages are not recoverable for loss that the injured party could have avoided without undue risk, burden or humiliation.

(2) The injured party is not precluded from recovery by the rule stated in Subsection (1) to the extent that he has made reasonable but unsuccessful efforts to avoid loss.

RESTATEMENT (SECOND) OF CONTRACTS § 350(1) (1979). Article 77 of the C.I.S.G. similarly limits recovery. It provides:

A party who relies on a breach of contract must take such measures as are reasonable in the circumstances to mitigate the loss, including loss of profit, resulting from the breach. If he fails to take such measures, the party in breach may claim a reduction in the damages in the amount by which the loss should have been mitigated.

C.I.S.G., *supra* note 1, art. 77. For the importance of this when a party relies on Article 74, see J. HONNOLD, *supra* note 9, at 418.

237. See RESTATEMENT (SECOND) OF CONTRACTS § 351(3) (1979). For thoughtful discussions of this new subsection, see Harvey, *Discretionary Justice Under the Restatement (Second) of Contracts*, 67 CORNELL L. REV. 666 (1982); Young, *Half Measures*, 81 COLUM. L. REV. 19, 24-30 (1981).

238. RESTATEMENT (SECOND) OF CONTRACTS § 351(3) (1979). See Farnsworth, *supra* note 234.

239. H. HUNTER, MODERN LAW OF CONTRACTS, BREACH AND REMEDIES ¶ 7.03[3][e], at 7-17 (1986).

240. *Id.*

241. Stone, *Recovery of Consequential Damages for Product Recall Expenditures*, 1980 B.Y.U.

several factors which, in addition to foreseeability, a court will consider as relevant in allocating the loss and makes a good case for relieving to the supplier from damages which the supplier had reason to foresee.<sup>242</sup>

This approach is more open about the reasons for limiting the damages than either the "tacit agreement" rule or the "unforeseeable" test.<sup>243</sup> A statement that the recovery is unjust is a more accurate reflection of the thoughts of the judge than one that dwells in the never-never land of contracting parties who make a collateral contract ("I accept the responsibility") to ride piggy back on another collateral contract ("You will be liable for consequential damages as well as direct") which in turn is tacked on to the actual contract of the parties. Still, the Restatement subsection itself is admittedly a novelty and not reflected in existing law.

## (2). The "In-Between" Cases

Some courts have read the *Hadley* rule to require an all-or-nothing recovery (usually meaning nothing for the injured party) and have rightly been criticized for not permitting other possibilities (unless no loss was foreseeable).<sup>244</sup> Nevertheless, both the wording of Article 74 and the results of cases following *Hadley* show that this need not be the result. The basis for not

L. REV. 485; Stone, *Allocation of Risk for Product Recall Expenditures: A Legislative Proposal*, 1975 DET. C.L. REV. 1 [hereinafter *Allocation of Risk*].

242. *Allocation of Risk*, *supra* note 241, at 5-6. The factors are:

- (a) Is the seller compensated for the risk?
- (b) Is there a gross disparity between the compensation received by the seller and the damages sought by the buyer?
- (c) Was the breach by seller willful?
- (d) Factors with reference to interpretation and construction of seller's and buyer's contract for allocation of risk: (i) Did seller and buyer agree to extend liability to include the damages in question, or to limit or preclude liability for the damages in question? (ii) Are the seller and buyer in a relatively equal bargaining position, or is there a great disparity? (iii) Is the agreement between seller and buyer so one-sided that the court will not enforce their agreement? (iv) Was the agreement bargained out or was the agreement essentially a form contract with considerable "boiler-plate" language contained therein? (v) Which party chose the language of the agreement?
- (e) Where may the risk most economically be borne?

*Id.*

243. Yet there is a hint that RESTATEMENT § 351(3) is the "tacit agreement" rule in sheep's clothing. In fact, § 351(3) might well have been written as follows without much change of intent:

On occasion, consequential damages will seem disproportionate to the values apparently involved in the agreed exchange. When that is so the injured party may recover such damages only to the extent that the liability was within the tacit agreement of the parties.

Young, *supra* note 237, at 30.

244. Comment, *supra* note 50, at 1020.

allowing some in-between recovery must turn on what was foreseen by (or was within the contemplation of) the defendant, rather than on what was foreseeable objectively. It is highly unlikely that an in-between amount of loss was ever contemplated by either party.<sup>245</sup> The plaintiff may claim that he foresaw the amount that he asks for; the defendant may claim to have foreseen no loss. If, however, one takes the standard to be objective, there are other possibilities. For instance, the court may consider what the parties should have foreseen, even if the loss was not actually foreseeable by either (because of failure to get proper data).<sup>246</sup> The court can find as "foreseeable" a non-existing result—the amount plaintiff would earn under a normal contract, when in fact the plaintiff did not make a normal contract. This latter approach can be used not only when the party in breach faces a "harsh" result, but also when the result, though not "harsh," would be unfair because there was inadequate notice of a special purpose.

Shortly after *Hadley*, the courts began to acknowledge that the plaintiff should recover something, even while denying the amount claimed by the plaintiff because "not within the contemplation of" the parties. One example is *Horne v. Midland Railway Company*,<sup>247</sup> one of Sir James Willes's cases.<sup>248</sup> *Horne* involved a contract to supply military shoes at an unusually high price, a price unknown to the defendant. After the defendant breached, the goods were resold at a loss. The plaintiff was not awarded damages commensurate with the profit he would have made had the defendant not breached. The court reasoned that the profit was based on a price that the defendant did not know because the price was unusually high and therefore not contemplated by the breaching party. But even Sir James, the man who had successfully argued for limiting Baxendale's loss and who fashioned the "tacit agreement" rule,<sup>249</sup> awarded the plaintiff what would have been a "normal" profit. In that case, since the resale contract

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245. On the "thinking" aspect of this, see Gow, *A Comment on the Rule in Hadley v. Baxendale*, 27 AUSTL. L.J. 666 (1954) (considering how knowledge fits into the concept of foreseeability).

246. C. McCORMICK, *supra* note 70, at 565. "This standard is in the main an objective one. It takes account of what the defendant who made the contract might then have foreseen as a reasonable man, in the light of the facts known to him, and does not confine the inquiry to what he actually did foresee." *Id.* (footnote omitted).

247. *Horne v. Midland Ry.*, 7 L.R.-C.P. 583 (1872).

248. For the importance of Sir James Willes, see R. DANZIG, *supra* note 5, at 83, 97-100.

249. *British Columbia Saw-Mill Co. v. Nettleship*, [1868] 3 L.R.-C.P. 499.



was not in fact made, normal profit meant damages based on the difference between the market price and a supposed resale price.

In *Cory v. Thames Iron Works and Shipbuilding Company*,<sup>250</sup> the plaintiff bought a derrick from the defendant with the intention of using it to transship coal from colliers to barges without the necessity of intermediate landing. The most obvious intent was to use the hull as a coal store, while the use for transshipment was novel and unknown to the defendant. When the defendant breached, the value of the loss of the derrick hull as a coal store alone would have been £450. The loss measured by use to transship would have been much more. The defendant argued that not only should the larger sum be denied, but the £450 should be denied as well. The court awarded the lesser amount; Mr. Justice Blackburn considered that this award was necessary in order to follow the rule of *Hadley*, even though the amount was based on non-existent facts.<sup>251</sup> Still other cases illustrate that in-between recoveries were considered early on.<sup>252</sup>

A later case is *Victoria Laundry*<sup>253</sup> in which a seller who delayed delivery of machinery was liable for the normal profits lost (though they would not have been made by performance), not the unforeseeable exceptional profits (though they probably would have been made).<sup>254</sup>

Since Article 74 provides that the damages "may not exceed" rather than "must equal" the foreseeable loss, it is conceivable that even more imaginative awards will be fashioned.<sup>255</sup> A business person who has lost a profit should not be content with an award of only interest on the investment. The business person took a risk—an award of damage based on the difference between

250. *Cory v. Thames Iron Works and Shipbuilding Co.*, [1868] 3 L.R.-Q.B. 181.

251. *Id.* at 188.

252. *Elbinger Actien-Gesellschaft fur Fabrication von Eisenbahn Material v. Armstrong*, 9 L.R.-Q.B. 473 (1874); *Hammond v. Bussey*, 20 Q.B.D. 79, 88 (1887).

253. *Victoria Laundry (Windsor), Ltd. v. Newman Indus.*, [1949] 2 K.B. 528 (C.A.).

254. *Id.*

255. In an appropriate case it is conceivable that a court might even tailor recovery so as to split the risk between the two parties and meet the objection of one commentator that the traditional rule "usually permits only all-or-nothing recovery." Farnsworth, *supra* note 60, at 1209 (quoting Comment, *supra* note 50, at 1020); see generally Bulow, *supra* note 6, at 629 (analyzing the "tailoring" of recovery in *Earl Shipping Co. v. Afran Transport*, SMA No. 1674 (1983)). Any conclusion about fashioned awards must be made with reservations. See Young, *supra* note 237, at 22, "In general courts are resistant to half-measure solutions that are either notably crude or notably refined. They are more receptive to the idea that some component of a loss claim (such as lost profit) be excised and the remainder granted." *Id.* Yet Professor Young later cites cases of courts granting "relief by half-measure." *Id.* at 29-30 nn.55-58.

interest on money and the profit made by taking the risk is the worth of the risk.

### VIII. THE VIEWS OF OTHERS

Harmonization of results in cases under the C.I.S.G. will require the courts of each country to observe the decisions of courts of other nations. But early on, before the cases begin to be reported, some knowledge of the views found in civil law countries should be helpful to U.S. judges. What generalizations about the civil law, pertinent to the clauses of Article 74, may be reached?

In civil law systems, contract is part of the general law of obligations, which also includes tort. Generally speaking, just as fault is required in tort, fault also is required in order to recover certain contractual remedies in breach of contract, with some exceptions.<sup>256</sup> However, neither German nor French law requires fault in order to hold the seller of generic goods liable for failure to deliver.<sup>257</sup> This civil law concept is in accord with the C.I.S.G. and the Convention relating to a Uniform Law on the International Sale of Goods (USIL), neither of which requires fault to recover for failure to deliver or breach of warranty.<sup>258</sup> Article 74 merely requires that the loss be foreseeable by the party in breach. Under French law, as under that clause and the common law, the question is what loss was foreseeable by the "party in breach" rather than the loss that was foreseeable by both parties.<sup>259</sup>

Another clause of Article 74 uses the time of contracting as the point from which foreseeability is judged.<sup>260</sup> French law also uses that time.<sup>261</sup> In connection with the time of breach, there was a discussion of intentional breaches. The encouragement of intentional breaches should find little comfort on the continent. Depending on the circumstances, an intentional breach under the C.I.S.G. could amount to bad faith; good faith is expected under both the UCC and the C.I.S.G. . The concept of good faith in German law, expressed as *treu und glauben*, is even more influential than in the United States. There is, for example, a

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256. G. TREITEL, *supra* note 135, at 8.

257. *Id.* at 15, 16.

258. *Id.* at 23.

259. *Id.* at 160.

260. See C.I.S.G., *supra* note 1, art. 74; U.C.C. § 2-715(2)(a) (1987); *supra* note 93.

261. G. TREITEL, *supra* note 135, at 161.

legal duty even to negotiate a contract in good faith.<sup>262</sup>

In the area of consequential damages, the national law of France (as distinguished from French law under the C.I.S.G.) provides that although the party in breach generally is liable only for the damages that the party foresaw or should have foreseen, the limitation does not apply where the breach is due to the party's "fraud"—meaning an intentional breach.<sup>263</sup> Although in such cases where there has been an intentional breach and the party's liability is not limited to foreseeable damages, the breacher nonetheless is not liable for "indirect" damages.<sup>264</sup> This differentiation between "foreseeable" and "direct" damages may cause a U.S. judge some confusion since foreseeability is the test for both remoteness and causation in the United States.<sup>265</sup> To explain the French view, consider the example of one who sells a diseased cow and conceals the fact.<sup>266</sup> The seller is liable for both the loss of the cow and for other animals which contracted the disease, whether their loss was foreseeable or not. If, however, the loss of the other animals makes it impossible to cultivate land, the party in breach is not liable for this loss, because the loss to the land is considered indirect. Furthermore, if the inability to cultivate the land renders the victim unable to pay debts and creditors levy on the lands, the party in breach is not liable for this loss either. These losses are "indirect".<sup>267</sup>

Finally, with respect to "in-between" recoveries, (meaning that recovery may be allowed even though a special loss was not foreseen), the French view also supports the idea of awarding damages "to the extent of the loss," avoiding an all-or-nothing rule. For instance, the French requirement of foreseeability resulted in a rule that a carrier was liable for the "normal" value of parcels lost, even if that amount did not approximate the actual value of the parcel.<sup>268</sup>

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262. See Kessler and Fine, *Culpa in Contrahendo, Bargaining in Good Faith, and Freedom of Contract: A Comparative Study*, 77 HARV. L. REV. 401 (1964).

263. G. TREITEL, *supra* note 135, at 146. "What is meant by 'fraud' in this context is a deliberate breach of contract or one committed in bad faith . . . It seems that in French law . . . a deliberate breach (*faute intentionnelle*) is sufficient, even in the absence of a bad motive." *Id.*

264. *Id.* at 150.

265. *Supra* note 130 and accompanying text.

266. G. TREITEL, *supra* note 135, at 167.

267. Insofar as measuring the amount of damages is concerned, the German law does not recognize fault as a reason to alter the measure. Swiss and Australian law, however, do. *Id.* at 146.

268. *Id.* at 154; see also *id.* at 155 (comparing the result of *Victoria Laundry*).

## CONCLUSION

The United Nations Convention for the International Sale of Goods will provide a new experience for judges in interpretation. The law, as set down in the C.I.S.G. articles, represents a compromise among several countries and several legal systems. One of the goals of the C.I.S.G. is that the results of the cases decided under the C.I.S.G. will be harmonized. For U.S. judges, this harmonization means trying to reach results similar to those of judges from systems that do not recognize the doctrine of precedent and hence do not put the same emphasis on cases as does the common law system. This article has looked to that part of the C.I.S.G. concerned with consequential damages to consider what U.S. courts may do in interpreting the words contained there.

United States judges may be guided by past experience in this area, experience influenced somewhat by the British case of *Hadley v. Baxendale*. However, the law in the C.I.S.G. is definitely different from the rules of that case. The principle of the case—that there should be some limitation on the recovery of damages—is still a valid one. But the C.I.S.G. article does not reflect the so-called *Hadley* rules. The C.I.S.G. article also differs from the law of the UCC. These differences may lead to a variety of results. For example, the actual loss suffered by the party injured by a breach is more likely to be recovered, since it only need be foreseeable as a possible result. For another example, a seller suffering a loss classified as consequential damages, generally not recoverable under the UCC, would be able to recover for that loss under the C.I.S.G. article. For still another example, the flexibility allowed for awards should give judges an opportunity to state more frankly the reasons for awarding the amounts that they decide on in harsh cases. Next, there is an opportunity to grant “in-between” awards, even in cases which are not harsh, when the judge thinks that the plaintiff is entitled to a reasonable amount that is less than the amount he is seeking. Finally, although it does not represent a departure from present law, the C.I.S.G. should discourage intentional breaches of contract.