Chapter 2

Introduction to compensatory damages: types of loss, compensatory aims, and theoretical underpinnings

1. COMPENSATION, COMPENSATORY DAMAGES AND TYPES OF LOSS

Compensation means the award of a sum of money which, so far as money can be so, is equivalent to the claimant's loss. The loss may be pecuniary (that is, a loss of wealth) where the equivalence to the claimant's loss can be precise; or non-pecuniary (for example, pain, suffering and loss of amenity, loss of reputation, and mental distress generally) where the sum to be awarded as compensation cannot be precisely equivalent to the loss and where the only way to ensure consistency of awards is through conventionally accepted tariffs of value.

The remedy concerned to achieve compensation for torts and breach of contract is compensatory damages (that is, damages concerned to compensate). This is almost always a common law remedy although, as we shall see in chapter 16 below, equitable compensatory damages awarded in addition to, or in substitution for, specific performance or an injunction, may also be awarded for a tort or breach of contract.

By an award of damages a sum of money assessed by the court is required to be paid by the defendant to the claimant.[1] The usual function of damages is compensation; that is, damages are usually compensatory. But it would be a mistake to imagine that damages and compensation are synonymous. This is because some awards of damages are non-compensatory: ie damages may also be punitive or restitutionary or nominal or contemptuous. In this part of this book, we are solely concerned with compensatory damages.

This and the following fourteen chapters examine in detail the law on compensatory damages. The first seven chapters (chapters 2 to 8) cover the general principles of assessment and equip one with all that is basically needed to assess compensatory damages, whatever the type of loss in question. The subsequent five chapters (chapters 9 to 13) then put

1 Strictly speaking, this refers to unliquidated damages. For 'liquidated damages' for breach of contract, see below, ch 19.

flesh on those bare bones by examining compensatory damages for the different types of loss. Chapters 14 and 15 deal with two factors of relevance to, while not concerning the assessment of, compensatory damages, namely, awards of interest and limitation periods. Finally, chapter 16 looks at equitable compensatory damages for torts and breach of contract.

It is convenient to consider in a little more depth here the fundamental division between pecuniary and non-pecuniary loss and to explain the further division of types of loss adopted in chapters 9 to 13.

So starting with the fundamental division between pecuniary and non-pecuniary loss, money can be complete compensation for the former but not for the latter. As Lord Diplock said in *Wright v British Railways Board*,[2] '[Non-pecuniary] loss is not susceptible of *measurement* in money. Any figure at which the assessor of damages arrives cannot be other than artificial ...'

This distinction does not mean that there are never any difficulties in assessing pecuniary loss; for while in some cases compensation for monetary loss is mathematically obvious and exact (for example, pre-trial expenditure), in most instances the uncertainties of what would have happened but for the wrong, and of what will happen in the future, make the assessment of even the loss of monetary income (eg loss of earnings) problematical. Similarly, while reliance on market values is often the most accurate method of assessing pecuniary loss for, for example, property damage, any attempt to put a value on anything, other than money itself, involves some approximation. So the distinction is not between losses where the compensation is precise and losses where it is imprecise. Rather it is between losses which are of wealth, and can therefore be readily translated into money, and other losses.

But as non-pecuniary losses are not losses of wealth, how exactly are they viewed and compared? The traditional judicial approach is to treat some heads of non-pecuniary loss, namely loss of amenity, physical inconvenience, and loss of reputation, as analogous to proprietary losses and as losses over and above the claimant's distress or loss of happiness; such heads of loss, in contrast to pain and suffering and mental distress, are therefore assessed objectively with the severe distress of the claimant or his unconsciousness being regarded as irrelevant. On this approach, while pain and suffering and mental distress are compared in terms of the degree of distress suffered by the claimant, the other non-pecuniary

2 [1983] 2 AC 773 at 777. For similar judicial statements, see *The Mediana* [1900] AC 113 at 116; *West & Son Ltd v Shephard* [1964] AC 326 at 346; *Fletcher v Autocar and Transporters Ltd* [1968] 2 QB 322 at 335, 339–340, 363; *Heil v Rankin* [2001] QB 272 at 293.

losses are compared by examining the extent of the interference with, and the importance of, the 'personal asset' affected.

An alternative and preferable view is that to treat any non-pecuniary loss as analogous to a property loss is unrealistic and that ultimately all non-pecuniary loss is concerned with the claimant's distress or loss of happiness. Taking this approach the different heads of non-pecuniary loss must simply be regarded as different types of distress with the head of 'mental distress' being a residual category. In practice this approach would rarely lead to different results than the traditional judicial one for the courts would need to treat a particular personal injury or physical inconvenience or loss of reputation as affecting individuals' happiness in essentially the same way, just as they already do, for example, in assessing pain and suffering damages. So adoption of the alternative approach would not mean that the claimant who has made the best of his misfortune would be likely to recover less than the claimant who has not, nor that a claimant would be encouraged to present a long face to the court. But the alternative view does provide a sound theoretical explanation for non-pecuniary loss and hence for why, for example, some non-pecuniary losses are regarded as more serious than others. Moreover, there would be at least two practical differences. First, severe distress suffered by the claimant would merit higher damages under any of the heads of non-pecuniary loss and, secondly, an unconscious claimant would recover nothing for non-pecuniary loss.

Whichever of the two approaches is taken – and as yet there is little judicial support for any departure from the first traditional view – there ought to be uniformity between awards. In other words, similar awards should be made for similar non-pecuniary losses and more serious losses should be compensated by higher awards. This is dictated by the essential justice of like cases being treated alike. It also gives some certainty to the law which in turn aids out-of-court settlements.

Since the virtual elimination of jury trials in personal injury cases, uniformity has indeed become the prime feature of damages for pain and suffering and loss of amenity, with judges relying on a tariff system. Similarly in Fatal Accidents Act 1976 cases there is a fixed statutory sum for bereavement. There would also seem to be an awareness of the need for uniformity in respect of other non-pecuniary losses, such as mental distress, although the survival of jury trials in defamation cases hampers putting this into effect for tortious loss of reputation.

Of course the emphasis on uniformity in no sense explains how the level of award is reached in the first place. Why, for example, should damages for loss of amenity and pain and suffering resulting from blindness be assessed at (say) £140,000 rather than £1,000? The courts

are generally content to say merely that the level of awards must be fair and reasonable,[3] should keep pace with the times,[4] and should in no sense reflect the claimant's wealth.[5] This may be all that can be sensibly said. However, economists have suggested that a value can be put on injury or life by, for example, asking what people would be prepared to pay to avoid incurring that injury, or what they would be willing to accept to incur it.[6] But in general it is hard to see how either question can produce anything more than further guess-work and the latter would, in any event, produce astronomically high awards. Perhaps more hopeful is to think in terms of the cost of substitute pleasures; that is, a claimant should be enabled to buy whatever can in some sense be regarded as making up for the loss he has suffered or will suffer so that, for example, a blind man should at the very least be able to buy hi-fi equipment and compact discs, and the person disabled from skiing should be able to buy holidays in the sun.

It follows from this discussion that one way to divide the types of loss for the purposes of examining compensatory damages is simply to divide between pecuniary and non-pecuniary loss. But ultimately it has been considered preferable in this chapter to make a different and more detailed division of types of loss which, it is believed, accords more with the way lawyers are used to confronting and thinking about compensatory damages. The division adopted is therefore as follows: pecuniary loss (except consequent on personal injury, death or loss of reputation); personal injury losses; losses on death; loss of reputation; and mental distress or physical inconvenience (except consequent on personal injury or death).

It should be emphasised finally that this book's approach to compensation is novel in not dividing torts and breach of contract and then examining compensatory damages for different torts and contracts respectively. There are many common approaches to compensation, whether the cause of action be tort or breach of contract, and in order to bring these out it has been considered preferable to examine compensatory damages in respect of the different types of loss with the tort/breach of contract divide then being recognised, where helpful, under each of those types.

3 Eg *Rowley v London and North Western Rly Co* (1873) LR 8 Exch 221 at 231; *Scott v Musial* [1959] 2 QB 429 at 443; *Gardner v Dyson* [1967] 1 WLR 1497 at 1501; *Heil v Rankin* [2001] QB 272 at 294, 297.

4 Below, pp 186–187.

5 *Fletcher v Autocar and Transporters Ltd* [1968] 2 QB 322 at 340–341.

6 See Cane *Atiyah's Accidents, Compensation and The Law* (6th edn, 1999) pp 135–136.

2. THE COMPENSATORY AIMS

The aim of compensatory damages for breach of contract is to put the claimant into as good a position as it would have been in if the contract had been performed. For tort the aim of compensatory damages is to put the claimant into as good a position as it would have been in if no tort had been committed.

These compensatory aims are of fundamental importance. They guide the whole process of assessment. They clarify in general terms – subject to the limiting principles considered in chapter 6 – the losses which compensatory damages are concerned to cover.

The classic contract case laying down the aim of compensatory damages is *Robinson v Harman*[7] in which Parke B said:

> 'The rule of common law is that where a party sustains a loss by reason of a 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.'

Lord Blackburn's statement in *Livingstone v Rawyards Coal Co*,[8] a case concerning trespass to goods, is probably the most cited tort authority on this. He said that the measure of damages was:

> '... that sum of money which will put the party who has been injured, or who has suffered, in the same position as he would have been in if he had not sustained the wrong for which he is now getting his compensation or reparation.'

Many subsequent cases contain equally clear expressions of these central aims.[9]

For shorthand purposes, the two aims can be linked by saying that the aim of compensation is to put the claimant into as good a position as if no wrong had been committed. However, if one does combine the two aims in that way, one must be aware that very different results may ensue depending on whether the duty broken was a positive or a negative one; and that typically contractual duties are positive (hence the separate

7 (1848) 1 Exch 850 at 855.

8 (1880) 5 App Cas 25 at 39.

9 Eg for breach of contract, *Wertheim v Chicoutimi Pulp Co* [1911] AC 301 at 307; *British Westinghouse Co v Underground Electric Rlys Co of London Ltd* [1912] AC 673 at 689; *Monarch SS Co Ltd v Karlshamns Oljefabriker* [1949] AC 196 at 220; *The Heron II* [1969] 1 AC 350 at 414; *Doyle v Olby (Ironmongers) Ltd* [1969] 2 QB 158 at 167; *Tito v Waddell (No 2)* [1977] Ch 106 at 328–334; *Radford v De Froberville* [1977] 1 WLR 1262 at 1268; *Rees v Darlington Memorial Hospital NHS Trust* [2003] UKHL 52, [2003] 4 All ER 987 at para 130. For torts, see, eg *Shearman v Folland* [1950] 2 KB 43 at 49; *British Transport Commission v Gourley* [1956] AC 185 at 187; *Lim Poh Choo v Camden and Islington Area Health Authority* [1980] AC 174 at 186ff; *Dodd Properties (Kent) Ltd v Canterbury City Council* [1980] 1 WLR 433 at 456; *Swingcastle Ltd v Alastair Gibson* [1991] 2 AC 223; *Rees v Darlington Memorial Hospital NHS Trust* [2003] UKHL 52, [2003] 4 All ER 987 at para 130.

formulation of the aim as being to put the claimant into as good a position as if the contract had been performed) while tort duties are typically negative (hence the separate formulation of the aim as being to put the claimant into as good a position as if no tort had been committed).

The difference in results – between compensation for breach of positive contractual duties and for breach of negative tort duties – is best illustrated by reference to tortious misrepresentations inducing contracts. Say, for example, the claimant buys a car. The seller falsely misrepresents to him, and gives a contractual warranty, that the car is only one year old. In fact it is four years old. The claimant pays £5,000. The market value of a one-year-old car (but with the other characteristics – apart from the age – of the car the claimant buys) is £5,500 but the value of the car he actually receives (given its real age) is £4,000.

If the claimant keeps the car and brings a claim for damages for the tortious misrepresentation (whether for the tort of deceit or the tort of negligent misrepresentation), the aim is to put him into as good a position as if he had never entered into the contract. His damages will be £5,000 – £4,000 = £1,000. But if he brings an action for breach of contract, that is, for breach of the contractual warranty as to the age of the car, the aim is to put him into as good a position as if the statement had been true. His damages will be £5,500 – £4,000 = £1,500.

If the claimant made a bad bargain, so that the market value of a one-year-old car of that type is £4,500, not £5,500, he would be better off suing for tortious misrepresentation. His damages in contract would be £4,500 – £4,000 = £500 whereas in tort they would be £5,000 – £4,000 = £1,000.

3. THEORETICAL UNDERPINNINGS OF COMPENSATION

(1) Breach of contract

Fuller and Perdue in their seminal article 'The Reliance Interest in Contract Damages'[10] labelled the principle of putting the claimant into as good a position as if the contract had been performed as that of protecting the claimant's expectation interest. They regarded this, on the face of things, as an odd kind of compensation since it often puts the claimant into a better position than if no contract had been made. Hence the central question raised by Fuller and Perdue was, why should

10 (1936–37) 46 Yale LJ 52 and 373.

contractual damages usually protect the claimant's expectation interest? Why, for example, should damages not be restricted to ensuring that the claimant is made no worse off than if the contract had not been made – in Fuller and Perdue's terminology why should not damages be restricted to protecting the claimant's reliance interest?

A famous illustration of the distinction between damages protecting the claimant's expectation and reliance interests is provided by the US case of *Hawkins v McGee*.[11] The claimant had burnt his hand and the defendant, who was a surgeon interested in skin grafting, contractually promised the claimant to restore his hand to a perfect condition by an operation. The operation went wrong and, instead of having a perfect hand, the claimant's hand was made worse than it was before the operation. Two possible ways in which the damages for the breach of contract could be assessed were examined. The first was to deduct from the value of the hand before the operation the value of the hand as it was after it – in Fuller and Perdue's terminology this would protect the claimant's reliance interest. The second was to deduct from the value of a perfect hand the value of the hand after the operation – this would protect the claimant's expectation interest. The court held that for breach of contract the claimant was entitled to be put into as good a position as if the contract had been performed; hence the second measure of damages was awarded. In other words the claimant's expectation interest was protected.

Fuller and Perdue ultimately thought that at least for bargain promises – promises supported by consideration – protection of the expectation interest could be justified on two main grounds. First, that the expectation interest is the best measure of the claimant's reliance interest given that the latter is difficult to prove, particularly with regard to the forgoing of opportunities to enter other bargains.[12] But this seems a weak argument[13] since it is often just as difficult to prove what position the claimant would have been in if the contract had been performed as it is to prove what position it would have been in if no contract had been made. Moreover, difficulty of proof does not justify picking what on this reasoning would be an arbitrary measure.

Fuller and Perdue's second justificatory argument is, in contrast, a forceful one. This is, in essence, that protecting the claimant's expectation interest for promises supported by consideration ensures that parties reap

11 84 NH 114, 146 A 641 (1929).
12 (1936–37) 46 Yale LJ 52, 60–61.
13 For a similar persuasive criticism, see Friedmann 'The Performance Interest in Contract Damages' (1995) 111 LQR 628, 635–636, 638. See also Stephen Smith *Contract Theory* (2004) pp 78–96, 413–417.

the benefit of their bargains and thereby encourages the practice of bargaining. This in turn upholds the working of the market economy under which, through bargains, goods and services find their way to where they are most wanted.[14]

A similar approach is taken by the economics and law theorists, like Posner,[15] who argue that contract law is a system of rules and principles furthering economic efficiency and hence overall social welfare. As expectation damages for bargain promises give the claimant no less and no more than the value it has placed on the defendant's performance, they provide the defendant with an incentive to exchange resources with those who place the highest value on them; the efficient result is thereby promoted. Say, for example, A contracts to sell to B for £100,000 a machine that is worth £110,000 to B (ie that would yield him a profit of £10,000). Before delivery C comes to A and offers him £109,000 for that machine. A would be encouraged to break the contract with B were he not liable to pay B £10,000 expectation damages. Given that damages do protect the expectation rather than the reliance interest, C will not be able to induce a breach of A's contract with B unless he offers A more than £110,000 thereby indicating that the machine really is worth more to him than to B. The expectation rule thus ensures that the machine ends up where it is most valuable.

In contrast to the above justification is Fried's theory of 'Contract as Promise'[16] according to which, contract rests on the moral bindingness of a promise.[17] This is essentially a revival of the will theory of contract whereby a contractual obligation as against, for example, a tortious obligation is regarded as resting on the defendant's voluntary acceptance of that obligation; and a promise, as a matter of convention,[18] is a voluntarily undertaken obligation. On this approach the expectation interest is the obvious and natural measure of damages for all promises, even if gratuitous, since it represents the monetary equivalent of the defendant's promised performance. Fried expresses this as follows:

> 'If I make a promise to you, I should do as I promise: and if I fail to keep my promise to you, it is fair that I should be made to hand over the equivalent of the promised

14 (1936–37) 46 Yale LJ 52, 60–62.
15 *Economic Analysis of Law* (6th edn, 2003) ch 4. See also Birmingham 'Breach of Contract, Damages, Measures and Economic Efficiency' (1970) 24 Rutgers LR 273; Beale *Remedies for Breach of Contract* (1980) pp 159–164.
16 *Contract as Promise* (1981); see Burrows 'The Will Theory of Contract Revived – Fried's "Contract as Promise"' [1985] CLP 141.
17 Stephen Smith *Contract Theory* (2004) chs 3–4, esp pp 74–78, also supports a promissory rights-based justification of contract but for different reasons than Fried.
18 Fried *Contract as Promise* (1981) ch 2.

> performance ... In contract doctrine this proposition appears as the expectation measure ... [it] gives the victim of a breach no more or less than he would have had had there been no breach.'[19]

On this view, based as it is on moral 'rights' or 'principle', 'policy' and 'consequentialist' arguments put forward in Fuller and Perdue's market economy and Posner's economic efficiency explanations provide merely additional reasons for protecting the claimant's expectation interest, where the promise is a bargain promise.

More recently, in a superb article,[20] Friedmann has argued that, while synonymous, 'performance interest' is more appropriate terminology than 'expectation interest'; that the explanation for the law's protection of the performance interest is that it is the natural and obvious concomitant of there being a valid contract which confers a legal right to the promised performance; and that Fuller and Perdue's promotion of the 'reliance interest' (at the expense of the 'expectation interest') was misconceived and has had relatively little impact on the substantive law.

However, it should be stressed that all the above approaches, purporting to justify the protection of the expectation interest, run counter to many of the writings of one of the most influential English legal academics of the late twentieth century, Professor Patrick Atiyah.[1] A major thrust of Atiyah's work was that while protecting the expectation interest may have been justified in the nineteenth century, when people strongly believed in the moral bindingness of promises, and in upholding the free-market economy, it was far more difficult to justify in the late twentieth century. He therefore argued that protection of the reliance interest should be the normal rule and, while he did backtrack to some extent,[2] his predominant view was that traditional contract law protecting the expectation interest and built up on, what he regarded, as nineteenth-century laissez-faire values was dead or at least in its final death throes.

But his attack grossly overstated the position; for while the law does and should enable a promisor to escape from a contract more easily than in the past – reflecting a greater concern in today's age for the weak – there is still a large area where the expectation interest is and should be protected for breach of a binding promise. Indeed the development of promissory estoppel and the reform of privity potentially open the way

19 Fried *Contract as Promise* (1981) p 17.
20 Friedmann 'The Performance Interest in Contract Damages' (1995) 111 LQR 628.
1 *The Rise and Fall of the Freedom of Contract* (1979); *Promises, Morals and Law* (1981); essays 2 and 7 in *Essays on Contract* (1987). Similar views are put forward by Gilmore *The Death of Contract* (1974). See also Collins *The Law of Contract* (4th edn, 2003) pp 405–422.
2 *An Introduction to the Law of Contract* (5th edn, 1995) pp 27–34, 444–464.

for more promises to be legally enforced. Moreover, while in the US Second Restatement of Contracts, restriction to the reliance interest is suggested as a possibility under promissory estoppel or where there is a disproportion between the consideration and the defendant's liability,[3] there is no indication in England of the courts preferring to measure contractual damages by the reliance rather than the expectation interest.[4] Contract law, and its central protection of the promisee's expectation interest, remains fully alive and is in no sense dying. As Friedmann has written:

> '[T]he main thrust of modern law has been in the very opposite direction ... [T]here are no signs of weakening of the performance interest. On the contrary, one of the major trends in modern contract law is the strengthening of the protection accorded to the performance interest. Traditional limitations upon the availability of specific performance and upon the recovery of performance damages have either been removed or severely curtailed.'[5]

One final point, which concerns Fuller and Perdue's interest analysis, is that it does not seem particularly helpful and indeed may be confusing to subdivide the expectation interest into damages protecting the (subsidiary) reliance and expectation interests, although this is an approach often adopted by commentators. All possible confusion is best avoided by using the expectation and reliance interests to refer only to the overall interest that the damages are seeking to protect. If so confined, *there is no question of combining the different interests since they are mutually inconsistent.*[6]

(2) Torts

In the tort realm (with the exception of misrepresentation)[7] the theoretical underpinnings of compensation have not been discussed in relation to any controversy over what the compensatory aim should be.