THE PROFIT PARADOX: PROTECTING LEGITIMATE EXPECTATIONS IN TORT

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In the new era of concurrent liability, Commonwealth appellate courts have called for the rationalisation of the law of remedies across causes of action. Yet the formalistic logic of the current remedial rules applicable to misrepresentations actionable in tort and contract can yield widely discrepant results on the same matrix of facts. Anomalies are exposed where the contract was induced by a fraudulent or negligent misrepresentation, but the victim discovered the truth only after fully performing the contract. The plaintiff's lost profit margin on the performed work will usually but not invariably be fully protected in contract. The tort damages will usually equal the contract award where the misrepresentation was relatively minor, such that the court concludes that had the plaintiff known the truth, it would have renegotiated the contract price to reflect the actual circumstances, increasing the profit margin. However, where the misrepresentation was so serious that the fully informed victim would have refused to contract with the defendant under any terms, the award is calculated on the basis of the plaintiff's costs of performance, without any compensation for loss of profit. To circumvent this paradox, the courts have devised several stratagems to award the plaintiff damages for lost profit. This article shows these devices to be flawed, and that under the current orthodoxy, the law still leaves the defendant to enjoy the fruits of its tort. The author proposes an alternate rule which redefines lost profits in this context as reliance loss, submitting that this measure better achieves tort's remedial objectives of full compensation and deterrence.

En cette nouvelle époque de partage de responsabilité, les cours d'appel du Commonwealth ont appelé de leurs voeux une rationalisation des droits et recours pour l'ensemble des causes d'action. Néanmoins, la logique formelle des règles actuelles sur les recours contractuels et délictuels pour de fausses déclarations conduisent à des résultats différents dans des situations de faits qui sont identiques. Les anomalies sont mises au jour quand de fausses déclarations, par fraude ou négligence, ont conduit à la formation du contrat et que la victime n'a découvert la vérité qu'après avoir exécuté le contrat. Habituellement, mais pas toujours, en responsabilité contractuelle la victime peut recouvrer le profit qu'elle aurait réalisé sur l'exécution du contrat. Il est de même en responsabilité délictuelle quand les fausses déclarations sont relativement mineures et que la cour en vient à la conclusion que, si la victime avait connu la vérité, elle aurait renégocié le prix du contrat afin qu'il corresponde vraiment

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aux circonstances, augmentant ainsi la marge de profit. Cependant, lorsque les fausses déclarations sont si graves que la victime, si elle avait été pleinement informée, aurait refusé de contracter avec le cocontractant, quelles que soient les conditions du contrat, les dommages-intérêts sont calculés sur la base du coût d’exécution du contrat, et il n’y a aucune compensation pour la perte de profit. Cet article démontre la faille de ces mécanismes. Selon l’orthodoxie qui a cours aujourd’hui, le droit permet encore au cocontractant de jouir des fruits de sa faute. Comme solution de rechange, l’auteure propose une règle qui, dans ce contexte, rédifie la perte de profit comme une “reliance loss”; elle soutient que cette mesure permet à la responsabilité de mieux atteindre ses objectifs de compensation et de dissuasion.

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I. Introduction

In civil cases ..., the law doth rather consider the damage of the party wronged, than the malice of him who was the wrongdoer.¹

No one should be permitted to gain from his own wrongdoing.²

The new era of concurrency of liability in tort and contract³ presents the courts with an unprecedented opportunity to explore old territory, the law of remedies, from a new perspective. One motivation for pleading concurrent liability is to benefit from remedial advantages offered by one cause of action over the other, as the concurrency doctrine gaining judicial acceptance permits the plaintiff to select the most advantageous remedy, once judgment for all successful causes of action has been entered.⁴

Some courts have been inclined to erase this advantage. In one of the landmark decisions of the Supreme Court of Canada in concurrent liability, BG Checo International Limited v. British Columbia Hydro and Power Authority,⁵ La Forest and McLachlin JJ, after noting that the plaintiff had calculated its tort damages as exceeding its contract damages, continued:

In situations of concurrent liability in tort and contract, however, it would seem anomalous to award a different level of damages for what is essentially the same

¹ Bacon, Maxims of the Law Reg. VII.
² AG v. Guardian Newspapers Ltd (No. 2) [1990] 1 A.C. 109 at 644 (H.L.) per Lord Keith of Kinkel.
⁴ Rafuse, supra note 3 at 522 (D.L.R.); Henderson, supra note 3 at 194.
wrong on the sole basis of the form of action chosen, though, of course, particular circumstances or policy may dictate such a course.\(^6\)

Anomalous this may be, but where the remedial templates for tort and contract are laid over the same matrix of facts, the results can be startlingly different. This has stimulated judicial calls to rationalise the law of remedies for all civil obligations. The Supreme Court in *BG Checo* urged:

Rather than attempting to establish new barriers to tort liability in contractual contexts, the law should move towards the elimination of unjustified differences between the remedial rules applicable to the two actions, thereby reducing the significance of the existence of the two different forms of action and allowing a person who has suffered a wrong full access to all relevant legal remedies.\(^7\)

English, Australian and New Zealand courts have also expressed desire to shake off the shackles of precedent in the law of damages.\(^8\) Nevertheless, these judges have often failed to respond to their own invitation to create a flexible law of remedies.

This article revisits the first principles actuating remedial law, examining the area where liabilities and remedies in tort and contract most commonly intersect: when tortious misrepresentations induce the plaintiff to enter a contract, be it with the representor or with a third party. This examination will be guided by the following cardinal principles for the assessment of tort damages:

**The Full Compensation Principle**: The plaintiff must be fully compensated for all harm inflicted by the tortfeasor, at least to the extent that such harm was foreseeable at the time the tort was committed.\(^9\)

This first principle engenders a corollary, that the law of remedies should not be constrained by rigid rules or formulae for quantification if this could result in under-compensation of the injured party.\(^10\)

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\(^6\) Supra note 5 at 38.

\(^7\) Supra note 5 at 21, per La Forest and McLachlin JJ. *Hodgkinson v. Simms*, [1994] 3 S.C.R. 377 at 454, per La Forest J., shows a similar impetus to match the damage awards for breach of fiduciary duty and breach of contract arising out of the same facts.


\(^9\) In deceit, the rules of remoteness do not apply; see infra text at note 45.

\(^10\) See the cases cited, supra note 8; *Liesbosch Dredger v. S.S. Edison* [1933] A.C. 449 at 463 (H.L.) per Lord Wright.
The Prophylactic or Deterrence Principle: Remedial law should not encourage the commission of torts.

A contract is a private ordering of voluntary mutual legal obligations created by the parties themselves. Under classic contract theory, society has no interest in compelling performance of those obligations, provided the party in breach adequately compensates the other for all foreseeable harm arising from the breach. Contract law is not troubled by the prospect that a contract breaker may profit from its own breach. Any deterrent effect of contract damages is merely incidental. Tort law, in contrast, imposes obligations on all actors in society not to harm those in legal proximity to them; therefore there is a compelling societal interest in ensuring that such obligations are honoured. Thus tort does not emulate contract law’s generally tolerant attitude towards breaches of legal obligations, and remedial law should strive to reflect this more activist stance.

Tort’s deterrence objective dictates a corollary to the second principle, that a tortfeasor should not be permitted to profit from his or her wrongdoing.

The fundamental question in assessing damages in contract and tort is the same: what loss has the plaintiff suffered as a consequence of the wrong committed by the defendant? The measure for tortious misrepresentation is often submerged in a welter of ossified ‘rules’: what damage did the plaintiff suffer as a result of altering his position in reliance on the misrepresentation?

13 Subject of course to the specific requirements of the tort. This principle is modified by any choice of the parties to arrange their affairs so as to allocate risks in a different way than tort law: BG Checo, supra note 5 at 27; Henderson v. Merrett Syndicates, supra note 3 at 194 per Lord Goff.
This article contends that an inflexible concept of “reliance loss” in tort can result in serious under-compensation of the victims of misrepresentation, most acutely where they have been induced to enter into and perform contracts before discovering the truth. By formulating a more flexible, and realistic, concept of reliance loss in this context, the two maxims quoted at the beginning of this article may be brought closer to reconciliation.

II. The Current Methodology for Computing Damages Arising from Misrepresentations in Tort and Contract

The discussion will focus on the following paradigm, which will be familiar to lawyers handling construction litigation:

\[ P, \text{ a construction contractor, was induced by } D \text{ to enter into a contract to build a large project, by misrepresentations in the tender documents respecting the site conditions. } D \text{ at the time of tender possessed information contradicting the representations, but } P \text{ did not discover this until after } P \text{ had fully performed the contract. The misrepresentations had the consequence of rendering performance much more costly than } P \text{ had originally anticipated in pricing the contract, and } P \text{ sustained a substantial loss on the contract as a whole. At trial, } D \text{ is found concurrently liable for breach of contract and for fraudulent and negligent misrepresentation.}\]

How will the law quantify P’s damages? In particular, will D have to pay P its usual profit margin on the extra work required as a consequence of the unexpected site conditions?

2.1 The Contract Model

The contract model assumes that the representations were incorporated into the contract as express or (if need be) implied terms. The innocent party is to be put in the position it would have enjoyed had the contractual promise been performed, commonly described as protecting its ‘expectation interest’.\(^{17}\) The task is to identify P’s position had the representation been true. P would recover:

(a) all direct costs flowing from the specific breach;

(b) any indirect costs incurred by P if other aspects of the work were affected by the breach, such as delay in the work schedule; such costs may include increased overhead if the evidence supports this claim; and

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\(^{16}\) If fraudulent misrepresentation is proved, courts commonly also find negligent misstatement, where both have been pleaded: e.g., Opron Construction Ltd. v. Alberta (1994) 151 A.R. 241 (Q.B.).

(c) P’s loss of projected profits on the contract, provided that:

(i) P made a good bargain apart from the matter misrepresented, and

(ii) the breach related directly to the performance of work under the contract.

Under the contract model, P is not entitled to compensation for any losses not related to the breach arising from the misrepresentation, but resulting from other factors such as P’s own poor performance, or market or other forces which are a normal part of business transactions.

2.2 The Tort Models

The basis for measuring damages for tortious misrepresentation is a rule of causation: the innocent party is entitled to recover its losses flowing from altering its position in reliance upon the misrepresentation, so as to restore it to the status quo ante. Thus while contract is forward looking, assessing P’s hypothetical position if the contractual promise had been fulfilled (i.e., as if D’s misrepresentation had been accurate), tort looks backward, to assess P’s hypothetical position had the misrepresentation never been made, (i.e., as if D had disclosed the true state of affairs).

However, this basic principle operates in markedly different ways, depending on how the misrepresentation is considered to have affected P’s freedom of decision, and especially P’s assessment of the risks to be assumed under the

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18 Net of the costs of P’s performance had D kept its contractual promise.
19 As occurred in *BG Checo*, supra note 5; see Section 2.3, infra.
20 *BG Checo*, supra note 5 at 41.
21 Tempered by remoteness considerations in negligent misstatement, but not in deceit; see infra text accompanying note 46.
22 *Livingstone v. Rawyards Coal Co.* (1880) 5 App. Cas. 25 at 39 (H.L.); D.W. McLauchlan, “Assessment of Damages for Misrepresentations Inducing Contracts” (1987) Otago L. Rev. 370. Jane Stapleton objects to the status quo ante terminology, arguing that the tort measure seeks to place P in the position P would have reached by the date of trial, had D not acted tortiously [“The Normal Expectancies Measure in Tort Damages” (1997) 113 L.Q.R. 257 at 262]; while acknowledging the force of her criticism, I will retain the orthodox terminology to keep the present analysis in familiar territory.
proposed contract. The causation question becomes whether, had P known the true facts, P:

(a) would have refused to enter the transaction upon any terms (the ‘no transaction’ model), or

(b) would have entered the transaction nonetheless, but on different terms (the ‘successful transaction’ model).

Thus the court is required to embark on “a retrospective and hypothetical restructuring of anticipated conduct”. The difficulties of this exercise are eased somewhat by a gloss on the causation rule, that P is not required to show that D’s misrepresentation was the only or even the main cause of P’s decision to enter the contract; it suffices if the tort was an effective cause.

2.2.1 The ‘No Transaction’ Model in Tort

Where the court concludes that P would have refused to contract with D at all, had the true facts been disclosed, then P:

(a) recovers damages for the total foreseeable losses on the contract as a whole, including any expenses incurred as a consequence of the breach such as an allowance for increased overhead;

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(b) but recovers no damages for P’s disappointed expectation of profit on the contract. Thus any profit element in the normal overhead charge must be stripped out.\textsuperscript{27}

The consequence of the ‘no transaction’ analysis for D is far-reaching, for it renders D liable for any and all foreseeable losses\textsuperscript{28} which P suffers in performing the contract, regardless of whether those losses are directly connected to the matters misrepresented. This result flows from the linear logic of causation which links the misrepresentation to the contract to the losses.\textsuperscript{29} This model holds obvious attractions for the plaintiff where performance of the contract is a complex undertaking, such that it is difficult to isolate costs and to trace their cause.\textsuperscript{30}

In many ‘no transaction’ cases contract and tort damages will tend to equalise, as it is likely that a critical misrepresentation will also result in a contract breach affecting performance of the whole contract. However, the ‘no transaction’ tort model may yield a greater quantum of damages than under the contract model where, quite apart from the misrepresentation, P has made a bad bargain respecting other parts of the contract. According to \textit{BG Checo}, the ‘no transaction’ model frees P from the burden or the benefit of the rest of the bargain. Errors made by P in evaluating its risks under the contract and in pricing its bid are logically irrelevant; P is relieved of its bad bargain because it was induced by D’s tortious conduct.\textsuperscript{31} The only quantification question remaining is to assess P’s actual, not hypothetical, total losses arising from having entered the contract, net of all offsetting gains, in order to restore P to the status quo ante.\textsuperscript{32}

For example, where P is induced by a misrepresentation to purchase shares which it would not otherwise have acquired, it is irrelevant that for unrelated

\textsuperscript{27} \textit{Rainbow v. CN}, supra note 24 at 12-13, 14-16 (S.C.C.); \textit{BG Checo}, supra note 5 at 40.

\textsuperscript{28} Although in deceit foreseeability of losses is not required; see infra text accompanying note 46.

\textsuperscript{29} \textit{Rainbow v. CN}, supra note 24 at 17c (S.C.C.); also discussed in \textit{Rainbow (No. 1), supra note 24 at 702-703, 706-707; BG Checo, supra note 5 at 340; Hodgkinson v. Simms, supra note 7 at 442b-447c; KRM Construction Ltd. v. British Columbia Railway Co. (1982), 18 C.L.R. 277 at 304-305 (B.C.C.A.); Toteff v. Antonas (1952) 87 C.L.R. 647 at 650-51 (Aus. H.C.).

\textsuperscript{30} As the difficulties in proving so-called “delay claims” in construction cases attest.

\textsuperscript{31} \textit{BG Checo}, supra note 1 at 40d-j, approving McLauchlan, "Damages for Misrepresentations", supra note 22 at 375-78; \textit{Rainbow}, supra note 24 at 16f-17g (S.C.C.); \textit{Hodgkinson v. Simms}, supra note 7 at 446e-f.

\textsuperscript{32} McLauchlan, “Damages for Misrepresentations”, supra note 22 at 375-78, 410-17 [especially the second illustration at 377]. See \textit{Rainbow}, supra note 24 at 16f-g, 17a-f (S.C.C.); the defendant had pleaded that the plaintiff’s losses were solely due to the incompetence and inefficiency of the plaintiff in bidding and providing the catering services [\textit{Rainbow v. C N (No. 2) [1990] 2 W.W.R. 412 at 427}], but allegations that the plaintiff had made a bad bargain were swallowed up in the ‘no transaction’ causal analysis adopted by the Supreme Court.
reasons the shares were overpriced or even worthless at the time of acquisition. P is still entitled to compensation for all losses flowing from the contract, and is not restricted to damages for the diminution in value directly linked to the undisclosed matters, because P would never have been exposed to the risk of incurring such losses were it not for the misrepresentation.

The same principle applies to losses incurred by P after entering into the transaction due to subsequent events, even where the events triggering the losses are completely out of the control of either party. Thus where P has been induced by D to invest in real estate, or to make a loan secured by land, D will be liable for all losses incurred by P, even though these may result from a decline in the real estate market due to a general economic recession.

It is precisely because of the advantages which the ‘no transaction’ model holds for the innocent party that Sopinka J. in *Rainbow* created an evidential presumption in favour of P that, were it not for the tortious misrepresentation, P would never have entered the contract:

A defendant who alleges that a plaintiff would have entered into a transaction on different terms sets up a new issue. It is an issue that requires the court to speculate as to what would have happened in a hypothetical situation. It is an area in which it is usually impossible to adduce concrete evidence. In the absence of evidence to support a finding on this issue, should the plaintiff or defendant bear the risk of non-persuasion? Must the plaintiff negate all speculative hypotheses about his position if the defendant had not committed a tort or must the tortfeasor who sets up this hypothetical situation establish it?

Although the legal burden generally rests with the plaintiff, it is not immutable... Valid policy reasons will be sufficient to reverse the ordinary incidence of proof. In my opinion, there is good reason for such a reversal in this kind of case. The plaintiff is the innocent victim of a misrepresentation which has induced a change of position. It is just that the plaintiff should be entitled to say "but for the tortious conduct of the defendant, I would not have changed my position". A tortfeasor who says "Yes, but you would have assumed a position other than the status quo ante", and thereby asks a court to find a transaction whose terms are hypothetical and speculative, should bear the burden of displacing the plaintiff’s assertion of the status quo ante.

To rebut the presumption, D must adduce concrete evidence, not mere speculation, that P, had the truth been known, would still have changed its

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33 *Twycross v. Grant* (1877), 2 C.P.D. 469 at 478, 480, 489-91 (C.P.D. on appeal) and at 542-45 (C.A. on further appeal); *Toeff v. Antonas*, supra note 33 at 650-51, 652, 653-54 (Aus. H.C.).


35 *Hodgkinson v. Simms*, supra note 7 at 442b-443d. For a contrary view, redefining the problem as one of duty of care rather than of quantification, see *South Australia Asset Management*, supra note 23, which I have criticised in “Flight to the Fiduciary Haven”, *supra* note 23 at 216-20.

36 *Rainbow v. CN*, supra note 24 at 15-16.

37 *Hodgkinson v. Simms*, supra note 7 at 442a.
position and entered into a different, hypothetical transaction,\(^{38}\) or otherwise would still have suffered the same loss.\(^{39}\)

Clearly the Supreme Court in *Rainbow* was trying to benefit P in setting up a presumptive 'no transaction' scenario. Unfortunately for P, however, the 'no transaction' model also ignores the benefits of the bargain, that is, the expectation of profit which inspired P to enter the bargain in the first place. Whether this need be so in all cases will be explored later in this article.

### 2.2.2 The 'Successful Transaction' Model in Tort

Where D has discharged its burden of proving that, had P known the true facts, P still would have entered the contract, but on different terms,\(^{40}\) then P's recovery will be restricted to:

(a) all direct costs flowing from the specific misrepresentation;

(b) any indirect costs incurred by P if other aspects of the work were affected by the misrepresentation, including additional overhead if the evidence supports this loss; and

(c) compensation for P's loss of profits on the contract, to the extent that such loss is caused by the misrepresentation.

These heads of damage essentially mirror those recoverable under the contract model. The premise of the 'successful transaction' model is that P hypothetically would have negotiated a higher price or other more advantageous terms to reflect the increased risk under the contract revealed by full disclosure. The elements of the bargain are reintroduced, such that the measure of damages becomes the difference in financial consequences between the actual contract tainted by the misrepresentation, and the hypothetical contract negotiated by P armed with the true facts.\(^{41}\) Thus P is not compensated for any losses unrelated to the misrepresentation, but rather resulting from such factors as P's own poor performance.\(^{42}\) However, P regains the benefit of its bargain, and so can claim lost profits on the contract, camouflaged by the hypothetical price the court finds that P would have negotiated (which is assumed to include a profit element). The court, regarding the contract performance as a whole, may consider that the claim for lost profits is too speculative.\(^{43}\)

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\(^{38}\) *Rainbow v. CN*, supra note 24 at 15c-16j.

\(^{39}\) *Hodgkinson v. Simms*, supra note 7 at 441c-g.

\(^{40}\) Assuming that P preferred the 'no transaction' model, presumably because it offered greater damages on the particular facts.

\(^{41}\) *Rainbow (No. 1)*, supra note 24 at 706-707 per Esson J.A.; *Rainbow (No. 2)*, supra note 32 at 423-24 per Lambert J.A.

\(^{42}\) *Rainbow v. CN*, supra note 24 at 16g (S.C.C.).

\(^{43}\) e.g., *Begro Construction Ltd. v. St Mary Irrigation District* (1994), 15 C.L.R. (2d) 150 at 190, 200 (Alta. Q.B.).
One variation on this model was suggested by Mahoney J.A. in Kyogle Shire County v. Francis: where the misrepresentation persuades P to forego profits which P otherwise might expect to earn, for example, if P agrees to lower its price to reflect what D represents to be a reduced risk of problems with performance under the contract. This would also annex the foregone profits to reliance damages.

The quantum of damages awarded under the ‘no transaction’ and ‘successful transaction’ models may also vary depending on whether P has succeeded in fraud or negligence. At common law, deceit defeats any contractual terms purporting to limit or exclude liability. The damage award may also be larger in deceit because, as an intentional tort, the remoteness rules governing negligence do not apply; the losses therefore need not have been intended or even reasonably foreseeable by the fraudulent party, and are recoverable provided the necessary causal link can be established. The victim’s own negligence will not furnish a partial or a complete defence, whether the plea goes to want of care which enables commission of the fraud, or to want of care which goes to the loss subsequently flowing therefrom.

2.3 Comparison of the Models

The most significant discrepancy between tort and contract damages in our paradigm thus centres on the recognition of P’s disappointed expectation of gain from the contract as an actual loss. But it is only in the ‘no transaction’

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47 The causal link may be broken by a new intervening cause, including the plaintiff’s failure to mitigate its loss [Doyle v. Olby (Ironmongers) Ltd., supra note 46 at 168, 171; Smith v. Scrimgeour, supra note 23 at 795; Canson v. Boughton, supra note 24 at 553d-554g], or become just too attenuated, on a common sense view [Rainbow (No. 2), supra note 32 at 425-26 (B.C. C.A.)].
scenario within tort that such a loss remains entirely uncompensable in principle. The ‘successful transaction’ model accepts P’s lost profit margin as a tangible reliance loss; but where the misrepresentation goes to the root of the bargain, that profit is extradited from tort’s territory as an enemy alien, shrinking reliance loss to P’s own disbursements in performing the contract.

The contract model usually has at least one advantage over either of the tort models, in that P’s expectations of gain engendered by the representations will normally be protected without question, the only evidential difficulty being proof that such expectations were not too remote, within the rule in Hadley v. Baxendale. For this reason, plaintiffs will often plead that the pre-contractual representations were incorporated into the contract as implied terms. An ingenious plaintiff may hoist its case into a contract breach by pleading an implied contractual term that the defendant did not know of any undisclosed facts inconsistent with the facts represented in pre-contract negotiations, or by pleading an implied covenant that the facts disclosed were furnished in good faith and in the honest and reasonable belief in their completeness and accuracy; the pre-contractual misrepresentations then become evidence of breach.

Because only the losses directly traceable to the breach of the specific term are recoverable in contract, if the plaintiff otherwise made a bad bargain, or incurred losses on other parts of the contract, the contract model is not an attractive alternative over the ‘no transaction’ tort model.

On the other hand, the available remedies under the contract model and the ‘successful transaction’ tort model are tending to converge. Differences in the remoteness tests deployed by negligence and contract to curtail the compensable consequences of breach are evaporating, and it is probably only a matter of time before a unified test will erase the semantic distinctions.

Interestingly, it is in protection of P’s lost profits that the contract and ‘successful transaction’ models can diverge, in a situation such as BG Checo. Because BC Hydro’s misrepresentation forced Checo to do site preparation work outside the scope of the negotiated contract, in contract Checo could only recover its expenses in doing the extra work, but not any profit margin, on the

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50 Subject to the breach affecting a portion of the work for which profit was part of the bargain, as noted supra note 19.

51 (1854), 9 Ex. 341, 156 ER 145.


53 See Opron Construction Ltd. v. Alberta, supra note 16 at ¶2, ¶574-¶575, ¶576-¶617.

54 As was noted by McLachlin J. in BG Checo, supra note 5 at 41.

basis that this had not been bargained for. Thus BC Hydro in effect benefited from its own breach by paying for Checo's extra-contractual work only at cost, and not at market value (which would have included a profit element). Another way of viewing the situation is that the first contractor which had responsibility to clear the site was relieved of the consequences of its own breach by Checo's performance of the remedial work. Since presumably BC Hydro had an action for breach of contract against the clearing contractor, why should Hydro not be required to pay market value for Checo's additional services, and then seek indemnity from the first contractor against Hydro's liability to Checo? Contract's answer is that Checo, by undertaking the work without having negotiated a separate contract for it, was voluntarily incurring the risk of nonpayment.

This response is not unreasonable when one looks at Checo's contractual position in isolation. However, turning to Checo's concurrent rights in tort under the 'successful transaction' model, we find that Checo was entitled to recover profit for this extra work, on the premise that Checo, had it known of the true facts at the time of tender, would have negotiated a different contract to include this work, at a higher price including a profit margin. When the case was remitted to the trial judge, Cohen J. awarded Checo $1,637,679.12 in contract, and $1,713,451.73 in tort under the 'successful transaction' model, the difference of $75,772.61 reflecting an assumed 5% profit on the extra work. Thus the awards reflected, on the one hand, lower contract damages for Checo's failure to negotiate a new contract for the clearing work, and on the other, increased tort damages on the hypothesis that Checo had negotiated that new contract — even though the underlying proven facts were precisely the same.

Thus our exploration of remedies for concurrent liability arising from misrepresentations has revealed that:

(a) contract law does not always protect expectations of profit; and

(b) tort law on the other hand can protect expectations of profit, but only where the misrepresentation was not sufficiently serious to vitiate the innocent party's desire to enter the contract.

Both of these results contradict the orthodox view that the role of protecting expectations is always assigned to contract, and never to tort.

56 The reports of the multiple levels of litigation do not indicate whether the contractor with responsibility for clearing the right of way was ever sued by either BC Hydro or Checo.


58 This result has been rightly described as paradoxical: Joost Blom, (1994) 73 Can. Bar Rev. 243 at 249.
III. The Orthodoxy of Non-Protection of Profits in Tort

3.1 The Orthodox Rule

The conventional view holds that the *restitutio in status quo ante* premise of tort remedies dictates that the victim’s expectations of benefiting from the contract be ignored, even where those expectations were induced by the tortfeasor. In English common law, the fact that the tort may have been committed intentionally is irrelevant in this context. In *McConnel v. Wright*, Collins M.R. described deceit:

> It is not an action for breach of contract, and, therefore, no damages in respect of prospective gains which the person contracting was entitled by his contract to expect come in, but it is an action of tort — it is an action for a wrong whereby the plaintiff was tricked out of certain money in his pocket; and therefore, prima facie, the highest limit of his damages is the whole extent of his loss, and that loss is measured by the money which was in his pocket and is now in the pocket of the company. That is the ultimate, final, highest standard of his loss.

This orthodoxy, later revised to accommodate consequential damages directly flowing from the fraudulent inducement, according to McGregor has become accepted ‘beyond doubt’ in England and the Commonwealth.

The rule is so rigorous that a fraudster will escape with impunity if the victim still obtained a net benefit from the transaction, albeit less than what D had represented, even in the face of proof that the profit margin P was led to expect was attainable had the matter misrepresented been true. In contract, there is no equivalent requirement of net detriment, as the court can segment the contract and give damages for reduced profit arising from breach of one term.

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60 We shall see that most American states have adopted a different view, applying the ‘benefit of bargain’ measure for common law deceit actions, *infra* note 212.

61 [1903] 1 Ch. 546 at 554 (C.A.) [emphasis added].


64 *Smith v. Scrimgeour*, supra note 23 at 792. The Court of Appeal has held that the measure of damages under the “fiction of fraud” set up by the Misrepresentation Act 1967 is the deceit measure, which precludes recovery for loss of bargain [*Roscot Trust Ltd. v. Rogerson*, supra note 46], but this is still not free from doubt, as Lord Steyn expressly refrained from comment in *Smith v. Scrimgeour*, supra note 23 at 793.


When the ‘out of pocket’ rule is applied to misrepresentations inducing contracts for the purchase of an asset, recovery is based on the amount by which the purchase price exceeded the actual value of the asset acquired, i.e., ‘price paid minus value received’. This is a deceptively simple formula which is capable of being applied to both ‘no transaction’ and ‘successful transaction’ cases, but which can produce inconsistent results. McGregor would apply the same principle to contracts for the provision of services, while admitting that there are no direct illustrations outside the cases where misrepresentations induced the purchase of shares.

It would seem logical to apply the same measure where the innocent party is the supplier rather than the purchaser of an asset (be it goods or services), with only a slight modification: the difference between the price at which the plaintiff was induced to part with the asset and its actual (greater) value. Actual value could be determined by the price at which P, if fully informed, would have been prepared to supply its asset to D. This is the analysis used in the ‘successful transaction’ model, but it is rejected under the ‘no transaction’ model, where the actual value is to be assessed only on the basis of the cost to P of supplying those services, not the value they would hold on the open market.

McGregor and Treitel point out that P will be worse off under the tort measure only if, on the assumption that the representation was true, P had made

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68 In the ‘no transaction’ model, P’s damages consist of the full price paid, less the offsetting value of the asset received (and presumably retained, unless the transaction is unwound by the Court); P’s award under the ‘successful transaction’ model assumes that ‘value received’ represents the price P would have paid had P not been misled. See Section 4.2, infra, respecting the use of this reasoning as a device to protect the expectation interest.

69 As McLauchlan has demonstrated; see “Damages for Misrepresentations”, supra note 22, at 379-84.


71 McGregor on Damages, supra note 63 at ¶1721.

a good bargain.\footnote{This usually occurs because the value as represented exceeded the purchase price. I. Brown and A. Chandler show why the tort measure does not protect good bargainers, in “Deceit, Damages and the Misrepresentation Act 1967, s. 2(1)” [1992] L.M.C.L.Q. 40 at 55.} Obviously the converse is also true, that the tort measure is likely to be more favourable to the representee who had made a bad bargain in any event. They do not, however, query why tort law should favour the feckless representee which incompetently priced the transaction over its more prudent competitor, left with its tortiously induced expectations of gain unsatisfied.

The rule in \textit{McConnel v. Wright} that the \textit{status quo ante} measure must prevail begs the question of how tort law defines the concept of reliance loss, and why it should be restricted to the transfer of money from P’s pocket to D’s pocket. As Mahoney J.A. has rightly pointed out, there is “unresolved ambiguity” in the phrase “the position in which the plaintiff would have been had the tort not been committed”\footnote{Kyogle Shire Council v. Francis, supra note 44 at 414. Treitel concedes that the formula “may not be impeccable as there is more than one way of ‘not committing’ the tort of deceit” (“Damages for Deceit”, supra note 72 at 558).}.

Why should not the reliance losses incurred by P, having been tortiously induced to transfer its money or labour and materials to D, include the profits P legitimately expected to earn from the transaction, particularly where (as is usually the case) D’s misrepresentation has been directed at engendering that very expectation? What legal imperative requires that the deceitful or negligent tortfeasor be permitted to acquire the benefit of the victim’s materials and services merely for the out-of-pocket cost of supplying them? \textit{A fortiori} where a desire for profit has motivated D to engage in tortious practices?

We turn now to the answers to these questions offered by the defenders of the orthodox position.

\section*{3.2 The Justifications for the Orthodox Rule}

\subsection*{3.2.1 Tort Damages are Compensatory Only}

One commonly proffered explanation for the refusal of tort to protect a representee’s lost profit is that tort remedies are intended to be compensatory only, not punitive. As Andrew Burrows puts this argument:

As the tort consists of fraudulently or negligently making a false statement misleading the plaintiff, the aim should be to put the plaintiff into as good a position as if no statement misleading him had been made. Although the contrary has sometimes been suggested, the aim is not and should not be to put the plaintiff in as good a position as if the statement had been true, for this would go beyond the essence of tort. To put it another way, fulfilling the misrepresentee’s expectations would usually put him into a better position than if the tort had not been committed and would therefore be punishing the defendant rather than compensating the plaintiff.\footnote{A. Burrows, \textit{Remedies for Torts and Breach of Contract}, 2d ed. (London: Butterworths, 1994) at 172 [emphasis added].}
However, the same goal of not punishing the wrongdoer is recited for damages in contract. The compensatory justification for the orthodox position slides over this objection by resolutely relegating the misrepresentee’s expectation interest to the status of a hypothetical loss in the ‘no transaction’ tort model, while according it full recognition as an actual loss in the contract and ‘successful transaction’ tort models. P in our paradigm has fully performed the contract under the expectation induced by D that P will earn a profit through that performance, yet awarding P those profits in tort is regarded as over-compensating P, and so somehow punishing D — even though D still possesses the project constructed by P. Surely tort damages become punitive only where they exceed the sum of any loss suffered by P and any gain made by D as a result of the tort.76 Thus the compensatory justification begs the concept of loss itself.

3.2.2 The ‘essence of tort’ justification

A more potent justification offered is the ‘essence of tort’: to restore the plaintiff to the pre-tort position. Quoting again from Professor Burrows:

Damages for tortious misrepresentation are therefore fundamentally distinct from damages for breach of contract, where the plaintiff’s expectations are fulfilled by putting him into as good a position as if the contract had been performed. At a deeper level the distinction between the two rests on the difference between lying and breaking one’s promise, with the latter, unlike the former, generally comprising the breaking of a positive rather than a negative obligation. It is hence essential to distinguish between ... statements merely inducing the making of a contract and the terms of the contract.77

Why the law should take a dimmer view of breaking a promise than of lying remains unexplained. The moral force of the difference, where the intent and the result of the lie is to induce the representee to make a contractual promise to the representor, is elusive.

R.D. Taylor also defends the identification of expectations with contract, contending that the categorisation of words or conduct as a contractual term or a tortious misrepresentation is the product of a decision that P’s expectation interest is, or is not, worthy of protection. Thus to award expectation damages for deceit must be wrong, because the expectation interest does not ‘merit’ protection, apparently because it is a reliance-based rather than a promise-based expectation.78 However, where the misrepresentation is directed by D to engendering an expectation of profit in P, so as to induce P to enter the contract, any distinction between reliance-based and promise-based expectations founded on relative ‘merit’ must evaporate.

77 Burrows, Remedies, supra note 75 at 172 [emphasis added].
A similar circularity attends Waddams' argument that tort law should not tinker with expectation damages because whenever there is a strong case for holding D liable for P's expectation, D's statement should be treated as contractual. He contends that the law of contract formation is sufficiently flexible to achieve this objective in deserving cases.\textsuperscript{79} If the courts, rather than the parties, are freely to manufacture contracts \textit{ex post facto} via collateral warranties to achieve a desired remedial result, the distinction between voluntarily assumed and legally imposed obligations completely collapses.

Burrows makes a more persuasive argument for maintaining the distinction between tort and contract in the new era of concurrency, on the basis that contractors are liable for failing to benefit the plaintiff - for failing to make things better - while tortfeasors are liable for harmful interference with the plaintiff - for making things worse.\textsuperscript{80} Liability for harmful interference is readily justifiable, but liability for failing to benefit another is an unwarranted interference with an individual's freedom of action unless that individual has voluntarily assumed an obligation to confer such a benefit, through the medium of contract. For Burrows, this adequately justifies protecting expectation interests only in contract, and not in tort.

While this is a powerful argument for not assimilating tort with contract in a unified and homogeneous theory of obligations, it need not lead inexorably to the conclusion which Professor Burrows urges. The essence of an actionable misrepresentation is that the representor has interfered with the freedom of action of the representee, by influencing the latter to decide to assume legal obligations upon false premises. It is D who induces in P a false expectation that P will reap a benefit from the proposed contract, and it is P's performance of that contract, labouring under that expectation, which provides the proof of damage.\textsuperscript{81} In this context, the concern to protect the tortfeasor's freedom of action not to confer a benefit is misplaced.

Furthermore, the allocation of expectations solely to contract law has been seriously eroded by the protection tort has extended to the 'pure' (i.e. non-reliance based) expectations of gain cherished by the would-be beneficiaries in the imperfected legacy cases such as \textit{White v. Jones}.\textsuperscript{82} In \textit{Hill v. Van Erp}, where the High Court of Australia adopted \textit{White v. Jones}, Dawson J. robustly


\textsuperscript{81} S. Whittaker rightly points out that liability for fraud, innocent or negligent misrepresentations seems so borderline between tort and contract because D has created P's expectations, rather than merely impaired expectations P has acquired from other sources: “Privity of Contract and the Tort of Negligence” (1996) 16 O.J.L.S. 191 at 208.

defended the description of the disappointed legatee’s failure to obtain a benefit as a real loss rather than a “mere expectation”, stating that “in any event there is no rule preventing recovery of loss for loss of an expectation”.83 Gummow J. warned that care is needed before accepting as “universally applicable” the orthodox position that only contract protects expectations or benefits not realised.84 In the specific context we are considering, there is no palpable difference between expectations of a gift created by negligent services,85 and expectations of a contractual benefit engendered by tortious words.86

In any event, it is difficult to see how the ‘successful transaction’ tort model could be defended as implementing a permissible ‘failure to benefit’ justification for protecting P’s expectation interest, while the ‘no transaction’ tort model is disentitled from making the same claim.

3.3 The Questions Left Unanswered by the Defenders of the Orthodox Rule

Peter Cane in discussing misstatements which induce contracts observes:

It is a striking feature of the law that the victim of misrepresentation is given a wide choice of causes of action unhindered by qualms about whether any particular cause of action is contractual or tortious, or about the “proper relationship” between contract and tort.87

Quite the contrary: the question whether a particular cause of action is tortious or contractual is of vital importance to the victim of a misrepresentation, who may justifiably feel caught up in a game of roulette.

Was the misrepresentation made by a party to the contract, rather than by a third party? Was the misrepresentation incorporated into the contract as a term?88 Are contractual remedies unrestricted? If so, then the representee’s expectation of gain will be protected. If contract is unavailable or unappealing, then would the representee armed with the true facts still have entered into the contract, albeit on different terms? If so, then P can also claim damages for lost profits arising from the misrepresentation.

But if the misrepresentation was so fundamental to the commercial bargain that, had P known of the true facts, P would have refused to enter into any contract with D, then P’s expectations of profits remain entirely thwarted by the tort. If D keeps quiet, D may be able to induce P to complete performance of the contract, even at a loss, thereby acquiring P’s work product at cost. If D is

84 Supra note 83 at 743.
85 Or, as in White v. Jones, supra note 82, a negligent failure to provide promised services.
86 See Burrows, “Solving the Problem of Concurrent Liability” supra note 80 at 119-21.
87 Tort Law and Economic Interests, supra note 76 at 174.
88 Michael Amheim also has raised the injustice of having expectation damages depend on whether or not the misrepresentation was incorporated into the contract: “Some Damaging Truths about Damages” (1987) 50 Sol. J. 1642 at 1643-4.
caught out in its deception before performance is fully rendered, then D will still only have to pay P’s reliance costs, but not damages for P’s lost expected profits. Either way, once the misrepresentation is sufficiently serious to have tipped P into the ‘no go’ area where P would not have contracted at any price or on any terms had P known the truth, the cheaper it will be for the tortfeasor.

This paradoxical result defies common sense. It pressures a plaintiff to minimise the impact of the misrepresentation upon its decision to enter the contract, to avoid the burdens of the evidential presumption which Rainbow created to benefit such victims.

It is intriguing that no attention is paid by those seeking to justify the orthodox position to restoring the guilty party to its pre-tort position. The overzealous concern not to better the victim’s position often results in tolerance of an improvement of the tortfeasor’s own position. As Fleming notes, apparently without disapproval, tort’s refusal to give the victim of deceit the benefit of his bargain “may actually allow a cheat to escape scot-free and even profit from his fraud”. Why should it be the innocent party rather than the tortfeasor who must suffer the consequences of any imbalance resulting from the restitutio quae ante tort régime?

The question raised by the disparate results which the contract and tort models can yield is whether it is logical and necessary to tolerate this result, solely due to the form of action available to the innocent party. Given that the representee’s motives of self-interest are the same - to make a profit, and the representor’s motives of self-interest are the same - to induce the representee to enter into the contract through conveying erroneous information, and the result is the same - entry into a contract on a false basis, why should contract law protect the representee’s expectations, but not tort law?

It is submitted that the stock answer of the defenders of the orthodox position, which faults the innocent party for failing to protect itself by insisting that the representation be inserted into the contract as a warranty, is simply inadequate. The objection ignores the imbalance in the bargaining relationship created by D’s tort. It is D’s own legal wrong which, ex hypothesi, has lulled P into a false understanding of the risks of the contract. Why should the victim be penalised for its credulity and imprudence, while leaving the guilty party free to enjoy the fruits of its tort? The argument also assumes the existence of the perfect world which enamours legal economists, where parties have complete freedom to negotiate the terms of their contract; in reality, the representor often is a major market player which can force the representee either to accept the terms of a standard form contract or to relinquish the opportunity altogether.

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90 A question raised by LaForest and McLachlin JJ in BG Checo v. B.C. Hydro, supra note 5 at 38.
91 As where construction contracts are put out for tender by governments and other major corporations, as BG Checo v. B.C. Hydro, supra note 5, Rainbow v. CNR, supra note 24, KRM v. B.C. Rail, supra note 29, and Opron Construction v. Alberta, supra note 16, attest.
The operation of the orthodox rule has prompted some judicial unease. In *Kyogle Shire County v. Francis*, where the plaintiff had purchased land intending to subdivide and resell it at a profit, relying upon the negligent statement of a local authority that it was zoned to permit subdivision, Mahoney J.A. noted:

There is, in a sense, an element of injustice if the plaintiff cannot recover profits it would have made on the resale of the land. The fact that the plaintiff did not derive the profits was the direct result of the falsity of the representation which negligently the Council had made and the fact that he would not gain those profits was a matter which the defendant must be taken as having contemplated as the result of that representation ... If P says to D, "I am going to buy this land and if I do I will make large profits from the use of it by subdivision", and D says, "You should buy the land because you can use it for subdivision", I suspect that the reasonable man would see an injustice if D was held to have committed a wrong on P by negligently and falsely saying what he did and yet P could not recover the very loss which the parties had in contemplation. However, intuitive feelings of justice, at least those of the reasonable man, are not always infallible as a guide to the law.\(^\text{92}\)

Against this rather resigned conclusion that the law of remedies must tolerate a reasonably held sense of injustice must be set the frequent judicial pronouncements that common sense must reign in this area.\(^\text{93}\)

IV. Existing Devices for the Recovery of Profits in Tort

The orthodox tort measure also overstates its case, for there are several devices whereby tort law does protect the representee’s expectations from the contract in a ‘no transaction’ case, albeit in a haphazard fashion.

4.1 Evidential presumptions as to the value of the subject-matter of the contract

One of the problems bedevilling the ‘price paid minus value received’ formula is to establish the value of the differential, or indeed its existence. Tort demands that P have suffered an overall loss as a consequence of entering the contract;\(^\text{94}\) so the plaintiff must prove that the purchase price was greater than the value received. In contract it suffices merely to show that the asset changing hands was less valuable than that promised, even if P had made a good bargain in any event. Tort, however, requires that P’s pockets must not merely be less full; P’s pockets must be empty. In New

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\(^{92}\) *Supra* note 44 at 412 [emphasis added].

\(^{93}\) See *Banque Bruxelles v. Eagle Star*, supra note 24 at 854 per Sir Thomas Bingham M.R.; *BG Checo v. B.C. Hydro*, supra note 5 at 38 per La Forest and McLachlin JJ.

Zealand,\(^{95}\) and also in some states in Australia,\(^{96}\) tort plaintiffs have often fallen at this hurdle.

The solution adopted by some courts is to set up a presumption of damage, by pegging the value of the asset as represented at the purchase price; it is then logical to assume that the asset without those represented advantages is worth something less, and to peg the ‘value received’ variable on that differential. This presumption device was first used in the leading English case of McConnel v. Wright, where it was described by Cozens Hardy LJ as “a rule of convenience, and indeed almost a necessity”.\(^{97}\) The presumption has also been deployed to value services obtained by deceit.\(^{98}\)

The presumption equating price paid with value as represented is rebuttable. D may show that P made a good bargain, i.e. that the price P paid was less than the value of the asset as it was represented to be. P will then recover in tort only any difference between the low purchase price and the actual value, whereas the contract measure would give P the wider differential between the represented value and the actual value.\(^{99}\)

When the courts have difficulty setting the ‘value received’ part of the formula, increasingly they resort to the cost of curing the defect to provide the necessary evidence. This most often occurs in ‘successful transaction’ cases, but it has also been applied in a ‘no transaction’ situation, where the purchaser is unable to dispose of the asset to cut its losses. The cost of giving the property the value represented has been invoked to determine the reduced value of a


\(^{97}\) Supra note 61 at 559, approved by Collins MR at 555 and Romer LJ at 556; see also Gosling v. Anderson [1972] EGD 709 at 717, discussed by Taylor, “Expectation, Reliance and Misrepresentation”, supra note 78 at 146-47.


\(^{99}\) See McLauchlan’s example (“Damages for Misrepresentation”, supra note 22 at 383 n63), altering the facts in Chua v. Van Pelt (1977), 74 D.L.R. (3d) 244 (B.C.S.C.): where price paid = $95,000, cost of making good the representation = $10,000, and value as represented = $100,000, then contract damages are $10,000, but tort damages are only $5,000 [$95,000 - ($100,000-$10,000) = $5,000]. This is because the cost of making good has been partially offset by the excess of represented value over the purchase price. In Thomas v. Penner (1958) 25 W.W.R. 173 (B.C.C.A.) a fraudster unsuccessfully attempted to rebut the presumption that the plaintiff had paid full value in a land swap, by complaining that the price he himself had paid the plaintiff was excessive, i.e. he had made a bad bargain assuming that his own misrepresentation had been true. Waddams [Law of Damages, supra note 12 at ¶5.470 n. 98] castigates this result as “punitive”, without addressing why damages which would be compensatory when wearing a “contract” label become punitive when awarded in tort.
house infested with white ants,\textsuperscript{100} to remedy defects in a water supply,\textsuperscript{101} to remove urea formaldehyde foam insulation from a house,\textsuperscript{102} to move a master bedroom away from a neighbour’s adjacent garage,\textsuperscript{103} to repair cracked foundations and clean the carpets in a house,\textsuperscript{104} and to establish 200 acres of farmland as pasture.\textsuperscript{105} The courts evinced no discomfort that they were in effect giving the representees the value of their bargain.

These rebuttable evidential presumptions thus provide the court with ready tools which usually give an advantage to the innocent party. Taylor complains that if the presumption operates in all contracts of sale, it would virtually destroy the difference between the contractual and tortious measures.\textsuperscript{106} McLauchlan argues that the fact that the presumption can be rebutted in ‘good bargain’ cases, to reduce the tort measure below the expectation damage benchmark, maintains the demarcation between contract and tort damages.\textsuperscript{107} However, he also contends that the presumption device is not justified in principle, because in reality good bargains are frequently procured, making price paid a poor indicator of value.\textsuperscript{108} But given that P’s assessment of the bargain has been distorted by D’s misrepresentation, it must be relatively infrequent that P nonetheless is able to extract a good bargain from D.

McLauchlan also claims that McConnel v. Wright used the presumption merely to satisfy the requirement of some damage to complete the cause of action in deceit, not to quantify that damage. He maintains that it is inappropriate to apply the presumption to both steps of the analysis. However, if it is adequate to prove the existence of the damage, logically it is valid to use it also to quantify that damage.

At bottom these objections may be founded on a dislike of presumptions to bridge evidential gaps. However, where remedies for proven tortious misrepresentations are in issue, it is justifiable that the risk of a paucity of evidence be allocated to the tortfeasor rather than to the victim.\textsuperscript{109} It is reasonable to require the party in possession of the facts from the outset to bear the burden of showing that P’s financial interests were not ultimately harmed by D’s tort.


\textsuperscript{102}Roussel v. Saunders, supra note 101.


\textsuperscript{106}Taylor, “Expectation, Reliance and Misrepresentation”, supra note 78 at 147.

\textsuperscript{107}“Damages for Misrepresentation”, supra note 22 at 383.

\textsuperscript{108}Supra note 22 at 383.

\textsuperscript{109}As Sopinka J. reasoned in Rainbow, discussed supra text accompanying note 36. Wilson J. offered the same justification for the ‘opportunity cost’ device in V. K. Mason Construction Ltd. v. Bank of Nova Scotia discussed infra s. 4.2.2.
It cannot be doubted that the invocation of either presumption to establish the loss often will allow the innocent party to recapture its expectation of gain from the transaction, but under the guise of reliance loss.\textsuperscript{110}

\section*{4.2 Compensation for disappointed expectations justified as reliance loss}

The ‘price paid minus value received’ formula was soon seen as inadequate to deal with all the ramifications of a tortiously induced contract, and so the door was opened to admit other losses which directly flowed from the reliance of P on the misrepresentation.\textsuperscript{111} The early cases concerned consequential property damage,\textsuperscript{112} but the rule was soon expanded to cover purely pecuniary losses. In some cases the foreseeable financial harm from breach of the contract equates to the financial harm flowing from the tort, making damages the same in tort and contract.\textsuperscript{113} Three categories of such losses will be considered: lost profits from existing contracts with third parties, foregone opportunities to earn profits from other hypothetical transactions, and compensation where the tort consists of, or results in, failure to provide what the plaintiff bargained for in a contract with the defendant or a third party.

\subsection*{4.2.1 Lost Contracts with Third Parties}

The most obvious example of consequential damages fulfilling P’s expectations is where P has terminated\textsuperscript{114} or lost an existing or expected contract with a third party as a consequence of D’s misrepresentation. This device appears to have made its début in \textit{Barley v. Walford},\textsuperscript{115} where a silk printer cancelled existing orders when the defendant fraudulently represented that the printer was about to be prosecuted for infringement of a registered design. The printer obtained damages for the profits he had expected to make from those orders, as well as for lost profits during the time he had to be absent from his business to attend to the litigation.

An example of defeated expectations of future contracts is \textit{Bristow v. Moffat-Virtue (Qld.) Pty. Ltd.}\textsuperscript{116} The plaintiff lawnmower manufacturer was persuaded by a distributor to purchase engines which were represented as new when in fact they had been repossessed from another manufacturer and

\begin{itemize}
\item \textsuperscript{111}See \textit{Clark v. Urquhart}, supra note 59 at 67-68 per Lord Atkin.
\item \textsuperscript{112}e.g., \textit{Mullett v. Mason} (1866) L.R. 1 C.P. 559; see \textit{McGregor on Damages}, supra note 63 at \S\,1732.
\item \textsuperscript{113}e.g., \textit{Archer v. Brown} [1985] 1 Q.B. 401 at 418.
\item \textsuperscript{114}e.g., \textit{Majo v. Adams} [1970] 1 Q.B. 548 (C.A.).
\item \textsuperscript{115}(1846) 9 Q.B. 197.
\item \textsuperscript{116}(1962) Qd. R. 377.
\end{itemize}
"rebuilt", and were not in good working condition. The jury found the defendant liable for both breach of contract and fraud. On appeal, the Queensland Full Court held that the fraud damages should be assessed on the same principle as damages for breach of warranty. The damages that were foreseeable in tort could not be less than the damages for breach of contract. Thus the tort and contract damages were calculated to include a substantial award for loss of profits by way of lost customer contracts and loss of good will.\textsuperscript{117}

In \textit{N. Tadco Limited v. City of Winnipeg},\textsuperscript{118} the plaintiff developer relied on misinformation provided by the City of Winnipeg respecting the location of sewer lines. The mistake was discovered only after the plaintiff had installed connecting sewers leading to the wrong location. The resulting delay in the construction schedule forced the developer to renegotiate a lower price with its purchaser, who had lost the benefit of a tax write-off due to the delay. The developer's damages against the City for negligent misstatement included the difference between the purchase price under the original contract and the replacement contract, together with other consequential expenses incurred in the renegotiations. This result necessarily meant that the plaintiff's expected profit from the contract was protected in tort as an actual loss flowing from its reliance on the misrepresentation.

A highly speculative claim for lost profits was recognized in \textit{Billings Mechanical Ltd v. Lloyds Bank of Canada}.\textsuperscript{119} The plaintiff was induced to move its account from the Toronto-Dominion Bank to Lloyds Bank by the manager's promises of access to greatly increased credit facilities, which in turn induced the plaintiff to over-expand its operations. The company went into receivership when Lloyds Bank refused to extend the promised credit facility. Damages were calculated on the basis of the anticipated profits the business would have earned, had the plaintiff remained with its original credit facility with its former bank and had not extended its operations, even though the company's financial position had been marginal and its operations barely profitable before it moved its accounts to Lloyds. The trial judge expressly noted that this was an appropriate case to assess damages in the same way in tort as it would be in contract.\textsuperscript{120}

4.2.2 The Opportunity Cost Approach

While the device just discussed focuses on pre-trial loss of anticipated revenue from existing or expected contracts, the 'opportunity cost' approach (also known as the 'foregone gains' approach) deals with entirely hypothetical losses. The premise for the damages award here is that, if P had not been induced

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\textsuperscript{117}Supra note 116 at 392, 393-96.


\textsuperscript{119}(1987) 208 A.P.R. 54 (N.B. Q.B.).

\textsuperscript{120}Supra note 119 at 78.
by D to enter into this contract, P would have deployed its resources elsewhere in order to make a profit.\footnote{The foregone gains argument is analysed in detail by McLauchlan, “Damages for Misrepresentation”, supra note 22 at 384-94.} The defenders of the orthodoxy that tort cannot countenance damages for expectations tolerate the ‘foregone gains’ device because of the deft transformation of lost profits from unrecoverable ‘mere expectations’ to ‘eliance losses’.\footnote{Burrows, Remedies, supra note 75, at 176-78; Cane, Economic Interests, supra note 76 at 146-47; Fleming, Law of Torts, supra note 89 at 637-38; Waddams, Law of Damages, supra note 12 at ¶9.70-¶9.130; Stapleton, “Expectancies Measure in Tort Damages”, supra note 22 at 270.} In essence, the opportunity cost argument compensates P for the loss of a chance, that of making profits elsewhere, thereby importing all of the problems of causation and quantification which continue to trouble tort law in this area.\footnote{See Hotson v. East Berkshire AHA [1987] A.C. 750 (H.L.); J. Stapleton, “The Gist of Negligence, Part II: The Relationship between Damage and Causation” (1988) 104 L.Q.R. 389; H. Reece, “Losses of Chances in the Law” (1996) 59 M.L.R. 188.}

After being posited in the controversial case of Burrows v. Rhodes,\footnote{(1899) 1 Q.B. 816. See also Johnson v. Braham & Campbell, Limited [1917] 1 K.B. 586 at 588 (C.A.). The device made its tentative début in Canadian law in the fraud case of Rosen v. Lindsay (1907) 7 W.L.R. 115 at 119 (Man. C.A.) (in obiter).} the device was directly introduced in Esso Petroleum v. Mardon.\footnote{Supra note 5 at 821.} Lord Denning M.R. held that if the plaintiff had not been negligently induced to enter the contract, it was fair to assume\footnote{As indeed the trial judge had found.} that he would have found an alternative business in which to invest his capital, and that his sagacity would have resulted not only in retention of that investment without loan liabilities, but also in a reasonable profit by way of a return on his capital and earnings for his own work.

The foregone opportunities device has been embraced with enthusiasm by the Australian High Court,\footnote{State of South Australia v. Johnson (1981) 42 A.L.R. 161 at 175; Gates v. City Mutual Life Assurance Society Ltd., supra note 65, discussed infra; see also Sellars v. Adelaide Petroleum N. L. et al. (1992-1994) 179 C.L.R. 332 (H.C.).} and by the Supreme Court of Canada.\footnote{V.K. Mason Construction Ltd. v. Bank of Nova Scotia, [1985] 1 S.C.R. 271.} It recently was resuscitated by the English Court of Appeal,\footnote{East v. Maurer [1991] 1 W.L.R. 461.} and has now received the imprimatur of the House of Lords as “classic consequential loss”.\footnote{Smith v. Scrimgeour, supra note 23 at 792-93.} While the position of the New Zealand Court of Appeal is not entirely clear, it appearsthat it will consider the loss of a chance to earn profits in relation to the plaintiff’s actual, rather than hypothetical, investment, using a wider concept of consequential losses than other Commonwealth courts are prepared to countenance.\footnote{Takaro Properties v. Rowling, supra note 67 at 62-67, 69, 72; Canavan v. Wright, supra note 196; see also New Zealand Refrigeration Co. v. Scott [1969] N.Z.L.R. 30 (S.C.).}
This wide adoption of the opportunity cost mechanism to compensate for lost expectations of profit suggests judicial unease with the orthodox approach, particularly where the result is to leave the guilty party with the fruits of his or her wrong.

4.2.2.1 Evidential Problems

This device might appear to present the ideal solution to the problem of recovering lost profits in a ‘no transaction’ situation. It is firmly glued to a reliance-based rationale which looks familiar to tort lawyers. However, problems of proving such a hypothetical loss have largely thwarted its potential.

P must prove on a balance of probabilities that if it had not invested its resources in reliance on D’s tortious misrepresentation, P both could and would have used those resources in some other profitable venture or purchased another product with the same attributes. Contrast this evidential burden with a contract action, where P recovers damages for lost profits on its contract with D, the rationale being that D promised that P would make a profit on this contract.

It is extremely difficult to prove a hypothetical loss. The admissibility of a representee’s evidence about a hypothetical course of conduct had he or she not been beguiled by D’s misrepresentation is dubious, as lay witnesses can testify only as to facts, and not self-serving speculation. In any event, the problem will be to prove the availability of such alternative contracts, and the level of profit which P reasonably could have expected to earn on these non-existent contracts.

The Supreme Court of Canada tackled these evidential difficulties in VK Mason v. Bank of Montreal.132 The plaintiff construction contractor signed a contract with Courtot to build an office and retail complex, but only after being fully satisfied by a comfort letter from the defendant bank that Courtot was adequately financed to meet its payments. Before completion of construction, the owner and the bank became aware that the bank’s loan would not cover the cost of completion, but did not inform the contractor. The forced sale proceeds in the bank’s foreclosure action were not sufficient to pay the shortfall owing the contractor after substantial completion. The Supreme Court confirmed that the bank’s conduct towards the contractor constituted negligent misrepresentation. The trial judge had found that the plaintiff would not have signed the contract had it not been for the assurances from the bank,133 making the ‘no transaction’ model applicable. He then awarded V.K. Mason damages in tort equal to the balance outstanding under the construction contract, minus its anticipated

132 Supra note 128.
133 Ibid. at 276.
profit on the contract. The Supreme Court found this deduction to be an error. Wilson J., writing for the Court, stated:

While I tend to the view that there is a conceptual difference between damages in contract and in tort, I believe that in many instances the same quantum will be arrived at, albeit by somewhat different routes.

[T]he trial judge was wrong in subtracting profit. I believe that in principle one is entitled to assume that Mason would have found a profitable means of employing itself had it not been induced to work on the Courtot project by the Bank’s misrepresentation. This in my view is a reasonably foreseeable head of damage ... In equating Mason’s lost profit with the profit estimated on the Courtot project we are simply saying that this is a reasonable estimate of what Mason would have been likely to have made if it had decided to abandon the Courtot project and find other work. That is to say, the lost profit on this contract represents the lost opportunity for profit on any contract. If Mason had made an exceptional profit on the Courtot project it might be disentitled to an award of the entire amount of that profit in tort damages, but this would be only because it was not reasonably foreseeable that it would have made a similarly exceptional profit on some other contract.

On this reasoning, Wilson J. also found that the plaintiff was entitled to prejudgment interest on the award as of the date of completion of the actual project, to compensate for the lost opportunity to invest the profits which it had anticipated to receive on the contract. Her Ladyship concluded her reasons with the following rather enigmatic statement:

Although damages for negligent misrepresentation would normally be assessed in terms of actual loss, including lost opportunity, rather than loss of anticipated profit, in this case the commercial context in which the parties operated dictates that Mason’s loss should be calculated in the same way in tort as it would be in contract.

The Supreme Court implicitly recognised that P, by deploying its resources in performing the contract formed on false premises, had suffered a real loss. However, the rigidity of the restitutio in status quo ante rule prevented direct compensation for this actual loss, compelling resort to indirect and rather artificial hypotheses. To overcome the evidential problems, the Court constructed a presumption that P would have been able to deploy its resources profitably elsewhere, without referring to any requirement that P prove the availability of such contracts, nor that P’s commitment to the tortiously induced contract prevented it from concurrently performing those other hypothetical contracts. Another presumption had to be manufactured, that the level of profits on the contract in litigation and on the hypothetical contract would converge at the same point. The result is to render the value of the lost opportunity to make a profit precisely the same in tort and in contract in all cases to which the

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134 Ibid. at 279-80.
135 Ibid. at 285-86 [underscored emphasis in original judgment; italicized emphasis added].
136 Ibid. at 286.
137 Ibid. at 288.
presumptions apply. The decision nowhere analyses the "commercial context" which warranted departure from the "normal" rule of lost opportunity and resort to the anticipated profits on the contract brought into being by the tort.

Perhaps it is the very artificiality of the V.K. Mason approach, measuring the loss of profits on another hypothetical contract by the plaintiff's expectation interest on the actual contract in issue, which has inhibited courts in other jurisdictions from adopting the presumptive technique. Canadian courts themselves have evinced a certain reluctance to invoke the presumptions, or have required additional evidence to set them up; alternatively, they tend to find the presumption easily rebutted by the defendant. The consequence is that most claims for damages for lost opportunity seem to fail on evidential grounds.

These evidential problems may be grouped into three categories.

4.2.2.1.1 Lack of, or insufficiency of, evidence of the availability of other contracts

In Gates v. City Mutual Life Assurance Society Ltd., the plaintiff successfully proved that he had been misled by the defendant insurer's agent as to the terms of the disability insurance coverage he was purchasing. The High Court of Australia ruled that his action failed, however, because he had been charged the appropriate premium for the coverage he did receive, and he had not adduced evidence that he had foregone the opportunity to buy another disability insurance policy with the terms he desired.

The majority asserted that there was "no element of injustice" in imposing this burden on the victim of a misrepresentation. Since Gates appears to have been the first Australian case to consider the foregone gains device, this was a harsh result for the plaintiff, who had argued his case himself on the straightforward basis that he did not get the policy he had been told he was purchasing. This evidential gap was particularly unfortunate given that the terms the insured desired were readily available in other policies in the disability insurance market. The requirement of proving the availability of other contracts is troubling in any case, for it might well have been a representation that the defendant had a product which no one

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139 See 2435935 Manitoba Ltd. v. East St. Paul (Rural Municipality), [1995] 8 W.W.R. 337 at 346 (Man. Q.B.), striking out a claim by a developer against a municipality for lost profits when a development was cancelled after a building permit was invalidated, although it was acknowledged that evidence of the lost profits from the aborted project might be admissible at trial to prove the quantum of damages for loss of opportunity to proceed with other developments.

140 Supra note 65 at 605.

141 Ibid. at 603, 606, 608.

142 Ibid. at 607-608.
else in the market could offer which induce the plaintiff to purchase that product and no other.

Plaintiffs may also fall at the evidential hurdle if there was a downturn in demand for their services or product before or during performance of the tortiously induced contract, leading to a drop in price or a surplus of suppliers.143 Other claims have failed because there was only one “consumer” of the plaintiff’s specialised services, namely the defendant.144

The inherent problems in discharging the evidential burden are highlighted by comparing two recent decisions of the English Court of Appeal. In East v. Maurer145 the plaintiffs purchased one of two hairdressing salons operated by the defendant. During pre-contractual negotiations, the defendant falsely represented that he would not personally work in the other salon on a regular basis. Faced with this unexpected competition, the plaintiffs were unable to make a profit. The trial judge found the defendant liable for deceit, and awarded damages which included £15,000 for loss of profits during the time they operated the business, computed on the basis of the defendant’s own profit margin when he was operating the salon. The Court of Appeal allowed the appeal in part. Beldam L.J. accepted the proposition that loss of profits incurred while the plaintiffs attempted to realise the business to its best advantage was recoverable as “actual damage directly flowing from the fraudulent inducement”.146 However, His Lordship held that it was improper to use the salon’s prior profit record as the measure, since the defendant had not warranted that his customers would continue to patronize the salon. Instead, the trial judge should have considered the kind of profits which the plaintiffs might have expected to make in another hairdressing business bought for a similar sum, using a “jury assessment” rather than a mathematical computation, an appropriate sum being £10,000.147 Mustill L.J. (as he then was) approved the use of the profits of the salon actually purchased by the plaintiff as “some evidence” of the earnings of the putative new business in Bournemouth.148 The Court of Appeal apparently did not demand any evidence of the availability of any other salons possessing the same attributes (location, customer capacity, or market base) as the one the plaintiffs did purchase.

In Davis v. Churchyard149 two years later, a differently constituted panel of the Court of Appeal took a markedly conservative approach to the same

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144 e.g., only a public authority usually puts out road building contracts for tender; this defeated the contractor’s claim against the public authority for lost profits in Karl Mueller Construction Ltd. v. Commissioner of the North West Territories, [1991] 1 W.W.R. 289 at 309 (N.W.T. C.A.).
145 Supra note 129.
146 Ibid. at 466, citing Clark v. Urquhart, supra note 59.
147 Ibid. at 467, 468.
148 Ibid. at 468.
The plaintiff was induced to purchase a public house by the defendant's fraudulent representation that its turnover was £2,000 per week, when in reality it averaged only £1,500 per week. The plaintiff recouped his capital by reselling the business, and sued to recover his loss of profits. The trial judge refused to award damages for lost opportunity, on the basis that the plaintiff had not established that he would have made a net profit in any other hypothetical public house, considering that the claim was "complete speculation". He concluded that the turnover in the notional public house would only have been £1,500 per week, so the plaintiff had suffered no loss. Nourse L.J. confirmed this finding on the basis of the weak evidence called by the plaintiff to establish the availability of public houses with the desired sales figures. Yet there was no evidence that the plaintiff would have invested in a pub at all had he known that the turnover was that low; that was the reason the defendant had fraudulently overstated the revenues, to persuade the plaintiff to buy it.150

Nourse L.J., while accepting the principle in East v. Maurer,151 distinguished it on the basis that there appeared to be little evidence as to what another hairdressing business might have produced for the proprietor. As Chandler has pointed out, we are left with the curious result that a dearth of evidence of alternative purchases permits the court to look at the difference between the actual and expected profits in the business which the representee purchased, as in East, but the availability of other similar businesses will divert the court from the actual purchase to hypothetical purchases.152

The approach in East v. Maurer was criticised as being novel, excessively speculative, over-compensatory, and spilling tort damages into the realm of contract,153 but in 1996 it earned the approval of the House of Lords.154

4.2.2.1.2 Lack of Evidence that the Plaintiff Could Not Have Performed the Hypothetical Contract as Well as the Tortiously Induced Contract

The second evidential problem is illustrated by the House of Lords' decision in Swingcastle Ltd. v. Alastair Gibson.155 A mortgage lender was induced to make a loan on the basis of a surveyor's report which seriously overvalued the property. The case was classified as a 'no transaction' scenario. The lender claimed against the surveyor the shortfall on the loan after it had realized its security. Included in the claim was penalty interest of 45.61% payable upon default under the mortgage. The Court of Appeal had felt bound

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150 A point made by Chandler, "Fraud", supra note 149 at 37.
151 Supra note 129.
152 Chandler, supra note 149 at 36.
153 J. Marks, "Loss of Profits in Damages for Deceit" (1992) 108 L.Q.R. 386; Marks apparently overlooks adoption of the opportunity cost mechanism by the highest Canadian and Australian courts.
154 Smith v. Scrimgeour, supra note 23 at 792.
by precedent\textsuperscript{156} to allow the contractual rate of interest, but commented on the absence of evidence that the money lent would have been used for another transaction, on the same terms. Neill L.J. indicated that the evidence would have to be directed to proving an unsatisfied demand for loans, and suspected that such evidence would seldom be forthcoming.\textsuperscript{157} The House of Lords considered that the Court of Appeal had erred, in that the result was to make the surveyor the guarantor of the borrower’s covenant to pay penalty interest. Lord Lowry did not go so far as to require concrete evidence of unsatisfied demand for loans, but also criticised the lender\textsuperscript{158} for not having adduced evidence of how the money might otherwise have been profitably employed, and at what rates.\textsuperscript{159} Lord Lowry was prepared to guess at a rate of 12\%.\textsuperscript{160}

In a sharply contrasting decision, the English Court of Appeal in \textit{Smith Kline & French Laboratories Ltd. v. Long}\textsuperscript{161} was prepared to disregard compelling evidence that the victim of fraud had in fact suffered no loss whatsoever. The defendant Long, the manager of Swift Exports Ltd., had deceitfully induced the plaintiff to sell 16,800 packs of drugs to Swift at their “knock-down” ex-factory price, by representing that the drugs would be resold in Central Africa. In fact, Swift intended all along to sell the drugs in Holland, in the plaintiff’s trading area. This again was a ‘no transaction’ case. The plaintiffs conceded that the drugs sold to Swift had cost them nothing to produce, and that they were in a position to produce sufficient stocks to meet all demand. The trial judge dismissed the action in deceit on the basis that the plaintiff had suffered no damage. The Court of Appeal reversed, reasoning that since the \textit{restitutio in status quo ante} principle required that the market value of goods, without reference to the cost of production, be the measure of damage in the tort of conversion, the same rule should apply to deceit, even though this could result in a plaintiff obtaining damages higher than its true economic loss.\textsuperscript{162} Slade L.J. observed that it did not lie in the mouth of the tortfeasor to suggest that the owner might not have found a purchaser.\textsuperscript{163} The court seemed concerned not to let the fraudster go scot-free, but this anxiety has not held the same weight with some critics.\textsuperscript{164}

The Manitoba Court of Appeal took a different view of similar facts in \textit{Vita Health Co. (1985) Limited v. Toronto-Dominion Bank}\textsuperscript{165}. The defendant bank had provided a misleading credit report to one customer, Vita Health Co., about another customer, GNC, which led Vita to continue to supply GNC with

\textsuperscript{156}Baxter v. F.W. Gapp & Co. Ltd. [1939] 2 K.B. 271 (C.A.); subsequently overruled in part by the House of Lords in Swingcastle v. Alastair Gibson, supra note 155.
\textsuperscript{157}Ibid. at 1096.
\textsuperscript{158}The lender did not appear in the House of Lords.
\textsuperscript{159}Supra note 155 at 1102, 1103-1104.
\textsuperscript{160}Ibid. at 1104.
\textsuperscript{161}[1989] 1 W.L.R. 1.
\textsuperscript{162}Ibid. at 10B, 10H.
\textsuperscript{163}Ibid. at 10E.
\textsuperscript{164}See Burrows, Remedies, supra note 75 at 173-74.
product. The bank then appointed a receiver of GNC, leaving no funds available for other creditors. Vita successfully sued the bank for negligent misstatement and breach of fiduciary duty, and established a ‘no transaction’ case. Vita’s claim for its profit margin on the unpaid sales to GNC was denied, however. *V.K. Mason* was distinguished on the basis that there was no evidence that the plaintiff had lost the opportunity to make a profit by reason of its contractual commitment. Twaddle J.A. insisted that it was not possible to assume such an opportunity because a company in the business of selling goods must show that the sale to the insolvent customer so depleted its supply of those goods that it was unable to make other sales. The imposition of such a burden on the plaintiff is a considerable distance from the evidential presumptions with which the Supreme Court of Canada favoured the representee in *V.K. Mason*.

4.2.2.1.3 *Speculation in Quantifying the Lost Profits on the Hypothetical Lost Contracts*

Even where the plaintiff has led evidence showing that it lost contracts due to the defendant’s tort, this usually must be supplemented by evidence of the plaintiff’s historic profit margins on previous contracts, to prove the quantum of such losses.

*KRM Construction Ltd. v. British Columbia Railway Co.* shows the hazards of this requirement. Tender documents issued by the defendant fraudulently misrepresented the volume of material required for a unit price construction contract. In addition to operating losses of $4,000,000, the trial judge awarded KRM a further $4,000,000 for loss of the opportunity to bid on other contracts, on the basis that KRM was unable to raise another bid deposit or secure adequate financing or bonding because its resources were tied up in performing the contracts with the defendant. This was actually a conservative estimate, based on detailed expert evidence, because the plaintiff’s track record for the previous three years showed a return of two and a half times the average return earned in the construction industry. The British Columbia Court of Appeal concluded that the trial judge correctly found that KRM had lost opportunities to bid on contracts put out for tender, bids which would have been successful. However, it rejected the expert evidence quantifying those damages as too speculative, because the expert was forced to rely on data for highway and bridge construction due to lack of data for railway projects. In the face of evidence that KRM had lost $5.6 million on two projects, both in litigation, the evidence was regarded as too tenuous to justify requiring the defendant to underwrite KRM’s profits in a high risk industry for several years.

Given KRM’s successful track record on other projects, the defendant’s own admission that KRM was “far and away” the best contractor they had ever

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166 Supra note 29. See also *De Groot v. St. Boniface Hospital*, supra note 25.
167 Ibid. at 294-98.
168 Ibid. at 307.
had, and the fact that the litigation respecting the two loss-making projects was still unresolved, this was a harsh result. It also illustrates the extreme difficulty faced by the victims of misrepresentation, and hence the courts, in adducing credible evidence of the quantum of the hypothetical lost profits. In such circumstances it is arguably more logical to look at the more concrete evidence of lost profits on the tortiously induced contract, as the Supreme Court of Canada proposed in V.K. Mason.

Similar problems attend the valuation of the lost opportunity where the tort relates to the acquisition by the plaintiff of business premises. No two properties are identical in physical features or location, differences which can directly affect the success of the business and so the accumulation of good will as a marketable asset. Indeed, it can be reasonably assumed that the plaintiff had purchased the most advantageous available property within its means for its business, so that the alternative premises which the plaintiff lost the opportunity to acquire were inferior. This highlights the speculative and artificial nature of the assessment under the opportunity cost approach, when the plaintiff as a result of the tort has actually lost the value of the goodwill expected to be generated by the premises it did acquire.

While the valuation of a lost opportunity to make profit on the tortiously induced contract is far from unproblematic, the degree of speculation required is reduced because the evidence will already have established the underlying factual matrix of the identities of the parties to the contract, its subject matter, and the attendant risks of performance in the circumstances as represented and in reality. The Australian High Court has tackled these evidential problems in valuing lost commercial benefits in contract, in tort and under the Trade Practices Act 1974, concluding that once the basic causation question of the loss of the commercial benefit has been established on the balance of probabilities, then the court must then make an informed estimation of the value of that loss, making appropriate discounts for hypothetical possibilities that factors affecting that value might or might not materialise, based on the evidence pertaining to

\[169\] Ibid. at 294.
\[170\] As noted in County Personnel Ltd. v. Pulver & Co. [1987] 1 All E.R. 289 at 298 (C.A).
\[171\] Thus in Country Personnel Ltd. v. Pulver, ibid., where the plaintiff acquired a highly disadvantageous sublease as a result of the negligence of its solicitor, it was not entitled to claim damages for the value of a third party offer for the sublease and goodwill of £17,000 when the sale was aborted when the purchaser discovered the terms of the sublease; instead, the Court of Appeal directed the trial judge to quantify the value of a hypothetical saleable sublease and good will on other business premises, while conceding that the assessment must be speculative. Commercial Banking Company of Sydney Limited v. R.H. Brown & Co. [1971] 126 C.L.R. 357 (Aus. H.C.), dismissing an appeal from [1971] W.A.R. 201 (W. Aus. S.C.) illustrates how proof of the value of the foregone opportunity is easier to produce where the contract is for the sale of a readily marketable commodity (wool), as opposed to services or real property.

that transaction. The difficulty of the quantification task cannot justify ignoring the existence of the loss.  

4.2.2.2  Diversion from the Real Issues to Collateral Issues

It seems that few Canadian courts have been prepared to accept the presumption approved by the Supreme Court of Canada that the profits lost on the tortiously induced contract would be the same as those lost on the hypothetical "lost contracts". From my own experience as appellate counsel on two such cases, the parties, and hence the court, find themselves digressing into a lengthy excursus into the plaintiff's track record on previous contracts, with attacks on the profit margins earned there due to the differing terms of those contracts, circumstances of the competitive bids, nature of the work, conditions under which they were performed, and in general the fortunes or misfortunes of the contractor. All this evidence not only substantially increases the cost of trial but, more importantly, diverts attention from the real issue, the contract induced by the defendant's tort.

Thus while disappointed expectations can be forced into the orthodox tort mould by metamorphosing them into reliance losses, in practice the device engenders many difficulties for the trial process, with haphazard results. As Joan Wadsley has noted, the opportunity cost approach shows how thin the line between contractual damages and tort damages can be. It is submitted that it is fairer to the tortfeasor to make it responsible for the representee's lost profits on the very contract which was induced by the misrepresentation, profits which it was more likely to have foreseen, rather than to require it to underwrite the plaintiff's ephemeral lost profits on hypothetical contracts, subject to conjectural terms and conditions of performance.

4.2.3  Where the Tort Consists of, or Results in, Failure to Provide What the Plaintiff Bargained for

4.2.3.1  In a Contract with a Third Party

The much maligned decision of the House of Lords in Junior Books Ltd. v. Veitchi Co. Ltd. provides one of the most intriguing examples of awarding tort compensation for expectations of profit. The decision's notoriety derives

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174Ibid. at 349-51, 355-56, 362-68.
175Karl Mueller Construction Ltd. v. Commissioner of the North West Territories, supra note 144, and Opron Construction Ltd. v. Alberta, supra note 16.
176J. Wadsley, "Measures in Misrepresentation: Recent Steps in Awarding Damages" (1992) 55 M.L.R. 698 at 705; also noted by the High Court of Australia in Gates v. City Mutual Life, supra note 65 at 608.
177e.g., County Personnel v. Pulver, supra note 170, where the court would be required to speculate about the terms and market value of a sublease on hypothetical commercial property.
178[1982] 3 All E.R. 201 at 206 (per Lord Keith of Kinkel).
from the finding that a subcontractor owed a duty of care to an owner to avoid causing economic loss through installation of a defective floor in its factory. Often overlooked, however, is the basis of the damages calculation. The owner in selecting the product expected the benefit of lower overhead costs, resulting in higher net profits. This expectation was thwarted by the defendant’s negligent supply of a defective product, and loss of profits was therefore a proper component of the claim for pure economic loss.179

Another situation in this category arises where the defendant’s tort has caused the plaintiff to make a loan to a third party; the defendant’s liability frequently is not restricted to the lender’s out-of-pocket cost, being the funds advanced, but rather extends to the full shortfall resulting from only partial recovery from the debtor, thereby fulfilling the lender’s expectations of gain from the loan.180 In Alberta,181 but not in England,182 this liability may extend to penalty interest under the loan, at least where the defendant is guilty of fraud.

4.2.3.2 In a Contract with the Defendant

In an often overlooked decision of the Supreme Court of Canada, Karas v. Rowlett,183 the plaintiff was a tenant of business premises under a lease which gave him a five year option to renew at the same rent, subject only to the right of the landlord to sell the premises upon six months’ notice. The landlord wanted to repossess the premises, and so arranged a fake transaction of sale. The jury returned a verdict of deceit, and awarded the plaintiff $20,000 for lost profits for the full unexpired term of the lease and option to renew. This was upheld by a majority of the Supreme Court. The tort was intended to and did bring about the fraudulent termination of the lease and loss of the business; therefore, the damages from deceit were the same as the consequences of the breach of the obligations from which the plaintiff’s rights and interests arose, and so should be determined on the same basis as in contract.184

Interestingly, the Court also ruled that the fact that the tenant had acquired and profitably operated other business premises after receiving the notice to vacate was irrelevant in terms of mitigation; the defendant led no evidence that the plaintiff, who already had been operating three businesses successfully at

179 Ibid. at 206f.
181 Schwartz v. Stinchcombe, supra note 46 at 259.
182 Swingcastle Ltd. v. Alastair Gibson, supra note 155.
184 Ibid. at 252 per Taschereau J.
one time, was able to operate this new business only because his work capacity had been released by his landlord’s tort, nor was there evidence that conditions were such as to prevent him from running all of the businesses successfully in addition to the one of which he was wrongfully deprived.\(^{185}\)

Waddams reconciles *Karas v. Rowlett* with the standard tort measure on the rationale that the victim would have enjoyed the value of the contractual right of renewal of the lease if the wrong had not been done.\(^{186}\) Not all cases in this category relate to appropriation of the plaintiff’s existing contractual rights, however; a few lend support to a broader proposition that where the plaintiff is fraudulently or negligently deprived of the opportunity to exploit an asset acquired as a result of the tainted transaction itself, the victim must be compensated for the lost profits, even where the facts support a ‘no transaction’ analysis.\(^{187}\)

The tortfeasor’s deprivation of the plaintiff’s benefit of bargain also is invoked to explain the protection tort law affords to expectation interests arising from contracts for the provision of services, such as competent professional advice or medical services. For example, the measure of damages against a lawyer who has missed a limitation period for suing is based upon the chances of success in recovering damages for the client’s cause of action, and not upon the client’s out of pocket costs incurred in obtaining the inadequate legal services or conducting the litigation.\(^{188}\) The tort measure for the client’s expectation will not be discounted where he bargained, not for a chance of success, but for a specific protection; a solicitor who has failed to register a security will be liable to the value of the security which has been rendered unenforceable by his negligence.\(^{189}\) If the solicitor knows that the client is purchasing a property for resale, and negligently advises that it is free of all encumbrances, the measure of the client’s damages is not limited to the

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185 *Ibid.* at 249, per Kerwin J. (as he then was).
187 *Doyle v. Olby (Ironmongers) Ltd.*, supra note 46 at 167; *Esso Petroleum v. Mardon*, supra note 5 at 821A-B, 828H-829A; *Havens v. Hodgson* (1939) 64 B.C.R. 77 (S.C.); *Zauscher v. Earl* [1943] 2 W.W.R. 697 (B.C.C.A.); *Deminchuk Enterprises Ltd. v. Deer Valley Shopping Centres* (1993) 11 Alta. L.R. (2d) 179 (Alta. Q.B.); *McAllister v. Richmond Brewing Co. (N.S.W.) Pty. Ltd.*, supra note 8 at 200-201; *Siametis v. Trojan Horse (Burlington) Inc. et al.* (1979) 123 D.L.R. (3rd) 767n. (Ont. C.A.). While some such cases might be explained as compensation for the plaintiffs’ labour and efforts, this cannot disguise the award of consequential loss of profits in *Hopkins v. Butts* (1967), 65 D.L.R. (2d) 711 (B.C.S.C.), adopted by Aus. H.C. in *South Australia v. Johnson* (1981) 42 A.L.R. 161, where the vendor of land had advertised it for sale as an apartment site, knowing that it was zoned only for residential use. The zoning was changed midway through the trial, but the purchasers were awarded their loss of profits during the delay in commencing their rooming house operations, as well as damages for the loss of use of their purchase-money in the interim.
189 *Central Trust Co. v. Rafuse*, supra note 3.
difference in value of the property encumbered and unencumbered (i.e. the standard tort measure of 'price paid minus value received'), but also includes the loss of expected profits on the planned resale. Thus, the expectations of the client are protected by both the contract for professional services and the tort of negligence. The measures coincide because the loss is defined by the clients' expectations that competent advice will enable them to obtain their objectives.

This survey of devices shows that it is simplistic and misleading to assert that tort law does not protect expectations. It also has demonstrated that tort law currently treats the representee's expectation interest in a haphazard and fortuitous manner, with only the most strained claim to logic, consistency or commercial common sense. It remains the case that the more serious the misrepresentation, the more likely it is that the tortfeasor's gain from its wrongdoing will be judicially condoned. Under the current orthodoxy, tort can indeed pay.

V. Proposed Criteria for Recovery of Lost Profits

At the end of the Court case, either D or P must end up holding a bag of money labelled "gain" from the tainted transaction. The inescapable consequence of the orthodox remedial rules which deny the victim its profit margin in cases of the gravest misrepresentations, on the specious excuse that P would gain a windfall, is to leave the tortfeasor enriched by a windfall, since D has obtained the subject matter of the contract at cost rather than at market value.

To resolve this profit paradox, I propose the following rule.

5.1 The Proposed Rule

P should be entitled to recover tort damages for lost profits, as reliance loss, in the following circumstances:

1. D has made a representation of fact to P in order to induce P to enter into a contract from which D will derive a benefit.

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191 Cane, Economic Interests, supra note 76 at 143-44 explains this line of authority on the basis that the contract defines the end to which the defendant is under an obligation to exercise reasonable care to achieve and that this, not the cause of action, determines the quantum of damages. See also D. Friedmann, "The Performance Interest in Contract Damages" (1995) 111 L.Q.R. 628 at 639.
192 As the English Law Commission has recognised in the context of restitutionary damages: Aggravated, Exemplary and Restitutionary Damages (Report 247, released December 15, 1997), §3.40.
193 Thus encompassing the situation where D is not a party to the contract, but would benefit if P's defeated expectation of profit is not compensated in tort.
2. The representation was intended by D to engender in P an expectation of profit from performance of the contract.\(^{194}\)

3. That representation was false, and was deceitfully or negligently made by D.

4. The misrepresentation achieved its purpose of inducing D to enter into the contract.

5. P would not have entered into the contract had it not been for the tort.

6. Pursuant to the contract P has transferred an asset or other benefit (including P’s services) from which D will benefit, whether directly or indirectly.

7. The contract was fully or substantially performed by P before P was apprised of sufficient facts to know of its legal rights.

8. D will continue to benefit from P’s performance after paying P’s expenditures in performing the contract.\(^{195}\)

This proposed rule has not emerged from a vacuum of common law authority. Courts in New Zealand and in some American states\(^{196}\) have acknowledged the “profit paradox” identified in Part II of this article, and have deployed tort remedies to prevent the tortfeasor from reaping the profits of its wrong.

The reasoning of the New Zealand Court of Appeal in Canavan v. Wright\(^{197}\) is particularly enlightening. The plaintiff purchased a farm from the defendant, giving as security for the unpaid balance of the purchase price a property mortgage and a security instrument over the livestock. This instrument required the plaintiff to keep more stock than the land could support. The defendant’s fraudulent misrepresentation was directed specifically at the carrying capacity of the farm. The plaintiff claimed damages on the basis of the ‘price paid minus value received’ formula, together with loss of profits sustained through overstocking to comply with the security.

The Court of Appeal unanimously found that the lost profit was recoverable. Citing Kerr on Fraud & Mistake\(^{198}\) for the ‘price paid minus value received’ rule, Barraclough C.J. observed:

I think it would be a more accurate statement of the law if this passage opened with the words “Prima facie” for there seems no reason in principle for holding that the

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\(^{194}\) Thereby making P’s expectations of profit foreseeable, whether the contract or negligence test of remoteness is deployed.

\(^{195}\) So the transaction cannot be simply “unwound” by restoration to P of the price paid or any resources transferred.

\(^{196}\) Discussed infra, text accompanying note 212ff.

\(^{197}\) Supra note 8; see also New Zealand Refrigerating Company Limited v. Scott supra note 131 at 35.

measure of damages in an action for fraudulent misrepresentation on a sale should necessarily be governed by rules which are peculiar to a contract of sale. The action of deceit is designed to afford relief in every case in which a plaintiff suffers loss through acting on a fraudulent misrepresentation, at all events if the misrepresentation is made by the defendant with a view to some unfair advantage to himself...\textsuperscript{199}

The plaintiff’s claim for lost profits related to a loss incurred because he had, as a consequence of the misrepresentation, entered into a contractual obligation which resulted in him incurring losses, a head of damages of an entirely different nature than a claim that he had paid too much for the stock:

In an action of deceit on a sale loss of profits are [sic] not ordinarily the direct consequence of the misrepresentation and are therefore not ordinarily recoverable. But if they are the direct consequences of the misrepresentation and a fortiori, if they result from the carrying out of an obligation which is entered into as part and parcel of the contract which was fraudulently induced, there seems no good reason why they should not be recoverable in law in addition to the difference between the price paid for the whole property ... and the fair value at the time of purchase.\textsuperscript{200}

Barraclough C.J. cautioned courts to be vigilant to avoid double counting in such a claim; the effect of the misrepresentation as to carrying capacity would normally be accounted for in the ‘value received’ part of the formula, since it could be critical to ascertaining the value of the farm itself. However, the loss of profits from starving cattle would not be encompassed in the ‘value received’ calculation, because they flowed from steps taken by the plaintiff to perform a contractual obligation - that obligation having sprung from the very contract that was fraudulently induced - and so must be treated as a separate head of recoverable damage.\textsuperscript{201}

It is submitted that Canavan v. Wright provides very persuasive reasons for compensating \textit{P} for loss of profits suffered in the course of performing the very contractual obligations which \textit{P} was tortiously induced to assume. While normally \textit{P} could not recover damages for lost profits in performing its own contractual obligations, where that obligation is created by the tort of another it should be compensable as reliance damages.\textsuperscript{202} As the New Zealand Court of Appeal observed, this is a very different situation from a purchase contract, the paradigm for the orthodox tort rule, where the victimised purchaser can be fully indemnified by reimbursement of the purchase price and of any reliance expenditures.

Quite apart from this authority, it is submitted that principle also compels this result.

\textsuperscript{199} Supra note 196 at 798.

\textsuperscript{200} Ibid. at 799 [emphasis added].

\textsuperscript{201} Ibid. at 799.

\textsuperscript{202} In Commercial Banking Co. of Sydney Ltd. v. R.H. Brown & Co., supra note 171 at 351, the Australian High Court went even further, suggesting that where \textit{P} is induced to perform a pre-existing contract by the fraudulent misrepresentation of a third party (there, a false credit reference from the third party’s bank), then the fact that \textit{P} would have breached its contract had it known the true facts is not an impediment to recovery from the tortfeasor of its lost profits from the contract.
5.2 Rationales for Recovery of Profits

5.2.1 The Legitimacy of the Plaintiff’s Expectations

Tort law originally viewed the parties as being brought together by mischance rather than by a deliberate decision to deal with one another, a fallacy long since demolished. Nevertheless, it is still seen as inimical to tort principles to acknowledge the plaintiff’s expectations from that relationship. Yet those expectations ground the relationship itself, as Peter Cane points out:

It is not usual to think of liability for misstatements which induce contracts as involving the protection of contractual expectancies, but it is important to treat them in this way in order to understand properly the relationship between tort and contract. The crucial point is that, at the time of the defendant’s tort, the interest which the plaintiff was trying to protect by relying on the defendant’s statement was his interest in entering a contractual arrangement which measured up to his hopes of making a gain, or, at least, not suffering a loss.\(^\text{203}\)

Thus the orthodox tort measure gives only coincidental recognition to the fact that a plaintiff induced by a misrepresentation to enter a contract has a legitimate interest in performing the contract, to gain a profit or other benefit thereby. If the standard formula of ‘price paid minus value received’ is inadequate to recapture the value of the representee’s expectations of profit, that is justified on the basis that the defeat of those expectations by the defendant’s tort does not constitute an actual loss.

The ‘price paid minus value received’ rule was developed in the context of speculative investment contracts, where the plaintiff was acquiring an asset in the expectation that in the future it would increase in value (i.e., post-transaction gains). The seminal cases involved the purchase of shares in a business enterprise.\(^\text{204}\) The purchaser’s speculative expectations were disappointed because the asset so acquired (or, in the case of shares, the underlying asset) did not have this investment potential. The courts have been understandably reluctant to embark on an exercise of assigning a present monetary value to an inchoate expectation which may be contingent upon many other factors, and for which there may be no logical cutoff point. Yet we have also seen this speculation exemplified in the deployment of the ‘opportunity cost’ device to circumvent the ‘price paid minus value received’ formula.\(^\text{205}\)

This model is manifestly inapplicable where P legitimately expects to make a gain from performing the transaction itself, particularly through the price stipulated for the provision of P’s services or the transfer to D of other assets or

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\(^{203}\) Cane, Economic Interests, supra note 76 at 167-68.

\(^{204}\) Peek v. Gurney (1873) L.R. 6 H.L. 377; Derry v. Peek (1889) 14 A.C. 337 (H.L.); Smith v. Chadwick (1881) 20 Ch.D. 27 (C.A.); McConnell v. Wright, supra note 61; Clark v. Urquhart, supra note 59.

\(^{205}\) Section 4.4, supra at 23.
resources. Where this gain has been bargained for, the court is not drawn into a speculative and hypothetical exercise, but rather merely giving effect to the reasonable expectations of the innocent party lying at the heart of their relationship, which the defendant’s tort was instrumental in engendering. In cases of negligence, the remoteness test for damage should ensure that the defendant is not held liable for wholly unrealistic or unforeseeable expectations of profit, and the requirement for proof of damage may similarly curb fraud damages. Is this unduly intruding on the sphere of contract law? It is submitted that it does not, but rather explains the convergence of tort and contract damages through a more coherent conception of loss.

5.2.2 Deterring Wrongdoing by Preventing a Windfall for the Tortfeasor

Even those fashionably sceptical of the capacity of tort law to discourage harmful conduct will usually accept that deterrence remains important to the torts of deceit and even negligent misstatements, where fault remains a relatively uneroded foundation of liability.

Not surprisingly, the deterrence policy has been particularly forcefully expressed in cases of deceit. In Lazarus Estates Ltd. v. Beasley, Denning LJ (as he then was) asserted: “No court in this land will allow a person to keep an advantage which he has obtained by fraud... Fraud unravels everything.” So powerful is this public policy that it has required innocent beneficiaries of fraudulent conduct to surrender the fruits to the victim. Even where the evidence fell short of proving actual fraud, the courts of equity prevented the misrepresenter from benefiting from the statement, on the basis that to do so was “a moral delinquency”.210

However, the orthodox damage measure clearly does allow the tortfeasor in our paradigm to profit from its own wrong. In effect, it leaves the fraudster in a ‘win-win’ situation: either the deception will succeed entirely or, if detected, D will only have to pay the victim’s out of pocket costs, and not the real market value of those services or other assets obtained.

This unpleasant prospect has motivated courts in most American states to fashion a mechanism to entitle the victim of deceit to claim tort damages

206 As the remoteness rules do not apply to losses resulting from deceit; see Section 2.2.2, supra.
207 Markesinis & Deakin, Tort Law, 3d ed. (Oxford: Clarendon Press, 1994) at 37. For a contrary view, see Glanville Williams, “The Aims of the Law of Tort” [1951] C.L.P. 137, especially at 159-60. Most third party liability policies exclude indemnity for fraudulent conduct, thereby leaving the tortfeasor to bear the loss; see Stinchcombe v. Schwartz, supra note 46 upholding denial of insurance coverage to a fraudulent solicitor.
209 e.g., First City Trust v. Emery (1985), 64 B.C.L.R. 326 (S.C.).
211 A point noted in Selman v. Shirley 124 A.L.R. 1 (Orégon S.C. (en banc), 1938) at 12.
computed to give P the benefit of his or her bargain with the tortfeasor.\textsuperscript{212} This result is sometimes rationalised by a notional warranty of the truth of the misstatement, using ‘bootstrap’ reasoning that a fraud accompanied by a broken promise should cost the wrongdoer as much as the latter alone, and that the form of action should make no difference.\textsuperscript{213} The express justification for the ‘benefit of bargain’ measure is deterrence of the risk-taker who might be tempted to gamble on the ‘out of pocket’ measure as the only potential downside. Since this is generally not a concern respecting negligent misstatement, the rule generally applied by these American states is that the ‘out of pocket’ rule is the standard measure there.\textsuperscript{214}

Fuller and Perdue, in their classic 1936 article, had predicted that the American jurisdictions would look to the quality of the fraud involved to determine whether the fraudster should be held liable for the expectancy interest or only to reimburse losses, considering factors such as the degree of fault involved, the applicability of policy considerations surrounding business bargains, and whether the representations were express or implied.\textsuperscript{215} However, these factors have not figured significantly in subsequent cases, and the expectancy measure is the normal basis of recovery in all deceit actions in the great majority of American courts.\textsuperscript{216} The \textit{Restatement of Torts (2d)} advocates a compromise position, giving the victim the right to elect either the ‘out of pocket’ or the ‘benefit of bargain’ rule in any case where the latter measure can be established with reasonable certainty. The stated justifications for this choice are first, that in some instances a measure based on the representation being true would yield nothing to the victim (such as where P is induced to part with an asset for less than its fair market value by a representation that it was practically worthless), and second, that P may have difficulty adducing probative evidence valuing the thwarted expectation, and so receive nothing under the ‘benefit of bargain’ rule.\textsuperscript{217}

So powerful is the concern not to allow the tortfeasor to profit from his or her wrongdoing that even in jurisdictions which have rejected the ‘benefit of


\textsuperscript{213} \textit{Selman v. Shirley}, \textit{supra} note 211 at 12, 14, citing \textit{Williston on Contracts} (Rev. Ed.) §1392.

\textsuperscript{214} \textit{Cunha v. Ward Foods, Inc.} 804 F.2d 1418 at 1424, 1425; American Law Institute, \textit{Restatement of the Law, Torts 2d} (1977), §552A.


\textsuperscript{216} \textit{Restatement of the Law, Torts 2d, supra} note 214, Title E, §549 at pp. 114-15.

\textsuperscript{217} \textit{Ibid.} at 115. This is a reversal of the stance taken by the first edition of the \textit{Restatement} which espoused the “out of pocket” rule in all cases [Vol. 3, §549].
bargain' rule, such as Maryland, the courts have strained to expand the plaintiff's 'out of pocket' loss to encompass the cost of cure.\(^{218}\)

While English and Canadian courts thus far have recoiled from such radical measures, they have devised rules peculiar to the tort of deceit to express the principle that the law must not permit the representor to exploit its misrepresentation.

First, even a misrepresentation originally made innocently must be corrected by its maker immediately upon discovery of its inaccuracy; if not, the misrepresentation will be deemed retroactively to be fraudulent ab initio.\(^{219}\) Otherwise, D would have a strong inducement to remain silent, and so profit from P's continuing performance in ignorance of the truth. Yet what penalty is this, in reality, when measured against the advantages to D of having the contract fully performed at cost, if P's foregone contractual gains are not recoverable? It will remain in D's self-interest to perpetuate P's ignorance of the error, hoping that P will not discover the truth until P has fully performed the contract, when the only risk is potential liability for P's out-of-pocket costs.

Second, the law will allow rescission of a contract obtained by deceit even where it has been fully executed,\(^{220}\) but, at least at common law, not where the misrepresentation falls short of fraud.\(^{221}\) Consider the implications for our paradigm, if P succeeds only in negligence: the recoverability of P's lost profits

\(^{218}\) See Beardmore v. TD Burgess 226 A.2d 329 (Maryland C.A., 1967), where the purchaser of property was awarded the cost of connecting civic utilities on the basis that this expense was a "concealed addition" to the purchase price so that the purchaser was out of pocket that amount, even though there was no evidence that the price exceeded the fair market value of the property.

\(^{219}\) Brownlie v. Campbell (1880) 5 A.C. 925 at 950. This proposition has recently been doubted, in Thomas Witter Ltd. v. TBP Industries Ltd. (1994), 14 Tr. L. 145 (Ch.D.), on the basis that dishonesty must taint the original decision to make the statement. However, the dictum in Brownlie v. Campbell now seems well established: With v. O'Planagan, [1936] 1 Ch. 575 at 583 (C.A.); Toronto-Dominion Bank v. Peat Marwick Thorne Inc. (1991), 4 B.L.R. (2d) 220 at 248-49 (Ont. Gen. Div.); Robertson & Moffat v. Belson, [1905] V.L.R. 555 at 561-62 (Victoria C.A.).


\(^{221}\) Shortt v. MacLennan, [1959] S.C.R. 3, 16 D.L.R. (2d) 161; Abrey v. Victoria Printing Co. (1912), 2 D.L.R. 208 (Ont C.A.); Lucas (TN) Pty Ltd. v. Centrepoint Freeholds Pty Ltd., supra note 67. The English common law rule [Solle v. Butcher [1950] 1 K.B. 671 at 695-96 (C.A.) and Leaf v. International Galleries [1950] 2 K.B. 86 at 86, 93, 95 per Denning L.J.; Long v. Lloyd, [1958] 1 W.L.R. 753] was changed by the Misrepresentation Act 1967, section 1, providing that the right to rescission is not barred merely because the contract has been performed; the remedy is available however only where the representor was the other party to the contract, and not a third party. Waddams, Law of Contract, supra note 12 at ¶417 notes that the common law cases conflict, and argues that, especially in cases of misrepresentation, execution of the contract should be a relevant but not decisive factor to rescission.
becomes dependent upon the date when P discovers the misrepresentation. If it is
discovered after only part performance by P, P has the opportunity to consider its
position and elect whether to continue, renegotiate or abandon the contract. If the
truth is disclosed only after full performance, it is too late for P to elect to terminate
the contract and claim quantum meruit, which could compensate P for lost
contractual gains because the measure is based on market value.222 Since the
contract formation in a ‘no transaction’ situation is equally tainted by a fraudulent
or negligent misstatement, the asymmetry of the powerful remedy of rescission in
deceit and negligence is unjustifiable. Again, the law of remedies inadvertently
provides an incentive to the negligent tortfeasor to conceal the tort.

Thus the deterrence policy expressed by the liability rule is thwarted by the
quantification rules. Frustrated by the rigid notion of loss which constrains the
compensatory model, some Commonwealth courts have been tempted to look to
extraordinary measures of damages to do this work.

The ‘win-win’ situation enjoyed by tortfeasors persuaded Peter Pain J.
to posit the availability of exemplary damages in a deceit action,223 on Lord
Devlin’s premise in Rookes v. Barnard that they “can properly be awarded
whenever it is necessary to teach a wrongdoer that tort does not pay”, one
such category being where the defendant’s conduct was calculated to make a
profit for himself which might well exceed the compensation payable to the
plaintiff.224 Nevertheless, the availability of exemplary damages in deceit actions under English law has been unclear for some time,225 a
situation not assisted by a recent ruling of the Court of Appeal restricting
exemplary damages to torts where such awards were available prior to
Rookes v. Barnard.226 In Canada, in contrast, the limitations on exemplary
damages imposed by Rookes v. Barnard have been rejected by the Supreme
Court,227 and awards have been made in deceit actions,228 and even in

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222At least under Canadian law: Morrison-Knudsen v. B.C. Hydro (No. 2) (1978), 85
D.L.R. (3d) 186, especially at 224-35 (B.C.C.A.); Peter Kiewit Sons v. Eakins Construction
224Supra note 15 at 1226.
225In Metallund Rohstoff A.G. v. Acli Metals (London) [1984] 1 Lloyd’s Rep. 598, the
Court of Appeal assumed that exemplary damages are not available for deceit. McGregor
concurs that before Rookes v. Barnard, “exemplary damages would appear, somewhat
strangely, to have passed the tort of deceit by”, but contends that they should fall into Lord
Devlin’s second category, as “a profit-motivated deceit is easily envisaged” [MacGregor
on Damages, supra note 63 at 11738].
Commission has recently recommended a complete revision of the law of exemplary
damages which would abandon this restriction: Aggravated, Exemplary and Restitutionary
Damages, supra note 63 at ¶ 1738.
228Denison v. Fawcett (1958), 12 D.L.R. (2d) 537 (Ont. C.A.), appeal to S.C.C.
withdrewn [1958] O.W.N. 468n.; while this case concerned conspiracy to defraud,
Waddams rightly contends that there is no reason to distinguish between remedies for
deceit and conspiracy to defraud [Law of Damages, supra note 12 ¶ 11.240 at p. 11-13].
exceptional negligence cases. Exemplary damage awards for deceit have also been made in Australia.

Exemplary damages are not a satisfactory solution, for they are susceptible to charges that the victim thereby gains a windfall. Redefining the victim's loss to encompass thwarted profits from the tainted transaction would be a more precisely engineered tool to achieve deterrence than an unpredictable award of exemplary damages at large, computed upon a basis necessarily incapable of firm definition, could be.

Restitutionary damages may appear to be an attractive alternative. The premise is that D has been unjustly enriched by its wrongdoing, although that enrichment need not be equated to a corresponding deprivation of P. The goal is to strip D of those gains. Restitutionary damages therefore tolerate a windfall to P.

The quest for a principled basis for such a controversial result continues, and so English courts have been nervous about extending restitutionary damages beyond narrowly defined parameters. The English Court of Appeal recently noted that there is no English authority requiring a wrongdoer to account for a profit not based on the use of the plaintiff's property, and refused the remedy in a fraud case, stating:

I do not overlook the fact that the policy of law is to view with disfavour a wrongdoer benefiting from his wrong, the more so when the wrong amounts to fraud, but it cannot be suggested that there is a universally applicable principle that in every case there will be restitution of benefit from a wrong.

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229 Klar, Tort Law (Carswell: Canada, 1991) at 80 and infra note 378; see also Law Commission, Aggravated, Exemplary and Restitutionary Damages, supra note 192 at ¶5.53.


233 An unusual example of judicial boldness is A.G. v. Blake [1997] 1 All E.R. 833 at 843-46, where the Court of Appeal of its own motion suggested in obiter that restitutionary damages for breach of contract were available against a former SIS officer convicted of espionage for the Soviet Union, to strip his royalties from his memoirs published after his escape from a British prison.

234 Halifax Building Society v. Thomas [1996] Ch. 217 at 226. The Law Commission conceded that it was "very difficult" to find any examples [Aggravated, Exemplary and Restitutionary Damages, supra note 192 at ¶3.23-3.37]. The Canadian courts also appear to adhere to the property boundary, despite academic criticism: see Berryman, "The Case for Restitutionary Damages", supra note 232 at 334-35.

235 Ibid. at 227 per P. Gibson LJ; see also 229-30 per Glidewell LJ. The defendant had already pleaded guilty to criminal fraud charges.
At the time of judgment, P must choose between restitution and compensation, because the bases of claim are (rightly or wrongly) regarded as inconsistent and mutually exclusive. Because the restitutionary measure focuses exclusively on the wrongdoer’s gain rather than the victim’s losses, the victim might still remain out-of-pocket if the costs of performing the contract exceed the value of the end-product to the wrongdoer.

It also remains controversial whether the Court has jurisdiction to strip only part of the wrongdoer’s profits, to avoid the risk that full disgorgement would suppress economic activity without regard to the harm done. By an extended but realistic view of ‘reliance loss’, the measure proposed in this article retains a balance between P’s deprivation and D’s enrichment.

Quite apart from these problems in defining the parameters for profit-stripping in restitution, it can be extremely difficult to value the end-product of the tort. In our paradigm, what are the parameters for valuing a completed construction project in the hands of the owner? If it is a commercial enterprise, should the projected flow of revenues form a component of the restitutionary award, and if so, over what period? The problem is exacerbated if the project is not intended to create a revenue stream, such as a public works project, or has merely a subjective value for the owner which will not increase the property value on the open market.

Even the English Law Commission, while recommending that restitutionary damages become available across the spectrum of torts, including negligence, would award them only if D had made gains by “deliberately and outrageously” disregarding P’s rights. adverbs more colourful than precise. It is submitted that tort law, having created the profit paradox trapping victims of misrepresentation, should not negate its own promises to ensure that wrongdoing does not pay, by abandoning the field to restitutionary remedies still in their infancy.

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237 The English Law Commission argues that it does, but can cite only examples where defendants have been allowed an allowance for their efforts and expertise in enhancing the value of the asset acquired through their wrongdoing [Aggravated, Exemplary and Restitutionary Damages, supra note 192 at ¶3.25, 3.51]. See also Berryman, “The Case for Restitutionary Damages”, supra note 232 at 341-35.

238 See Birks, “Civil Wrongs”, infra note 243 at 88-89.

239 As in Opron Construction v. Alberta, supra note 16.

240 Professor Andrew Burrows, a strong advocate of restitutionary damages, was the Law Commissioner responsible for the Commission’s tort damages project.

241 Thereby aligning restitutionary damages with the Law Commission’s recommendations for punitive damages: Law Commission, Aggravated, Exemplary and Restitutionary Damages, supra note 192 at ¶3.51. This rule would remove one of the perceived advantages of restitutionary over punitive damages: see Berryman, “The Case for Restitutionary Damages”, supra note 232 at 345.
Defenders of the orthodox exclusion of expectation damages from tort, such as Waddams, contend that the criminal law provides sufficient deterrence of would-be fraudsters. This argument seems to equate deterrence with punishment, which tort law for the most part has resolutely resisted. It obviously begs the question of what constitutes loss. The rule proposed in this article is not punitive, as it can be directly related to P’s real, provable loss on the tainted contract, unlike the ‘opportunity cost’ approach. It is thus closely trimmed to the deterrent function of tort, avoiding the charges of asymmetry between D’s degree of fault and its monetary consequences often levelled against the compensation creed. The bargained-for profit builds in determinacy, the advantage claimed for the orthodox measure. In any event, civil and criminal fraud are separate and distinct foundations of liability which the victim may choose not to pursue concurrently. The shadow of a criminal prosecution should not be allowed to distort the proper role of tort as a mechanism for deterring wrongdoing.

Admittedly it is easier to defend the proposed rule in the context of deceit than negligence. However, the reliance loss reasoning in Canavan v. Wright applies equally to negligence and fraud. Arguments that negligence arises from inadvertent incompetence rather than fault, leaving no role for deterrence, are attenuated when applied to Hedley Byrne liability, which is founded upon advertent conduct - making statements with the subjective intention of inducing P to rely on them, without taking reasonable steps to verify their accuracy. The need to provide potential defendants with an effective incentive to exercise greater care not to disrupt the bargaining process by providing misinformation justifies at least reducing the discrepancy in remedial protection offered by the torts of negligence and deceit.

5.2.3 Absence of a Windfall for the Representee

The subtext to judicial reluctance to protect expectation interests in tort is a ‘windfall’ fear, that P will somehow get something for ‘nothing’, i.e. something for which P has not bargained and paid, and so will be in a better position than if P had never been induced to enter the contract.

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244Section 4.4, supra.
245e.g., Glanville Williams, “Aims of Tort”, supra note 207, 247 at 146-49.
247e.g., Glanville Williams, “The Aims of the Law of Tort”, supra note 207, 247 at 159-61. Even he concedes that the distinction between advertent and inadvertent conduct is complicated by the tortfeasor’s subconscious desires - which in our paradigm must lie very close to the surface.
The most commonly cited windfall scenario is where P has *acquired* an asset by paying an excessive purchase price. Suppose that P has purchased an asset for a price of $10,000; D however has represented the asset’s value at $30,000. However, P made a good bargain in any event, since the asset’s actual value at time of sale was $20,000. Griffith CJ of the Australian High Court in *Holmes v. Jones*,248 in defending the ‘price paid minus value received’ formula, argued that the American ‘benefit of bargain’ rule discussed earlier would yield “the most extraordinary results”, because P could recoup his purchase price of $10,000 *and get* $20,000 value of property for nothing. This is not correct. The American rule (like contract) would yield a damage award of $10,000, being the value represented [$30,000] less the value received [$20,000], which coincidentally equals the purchase price. Under the orthodox rule, in contrast, the tortfeasor escapes unscathed, because it was D, not P, who ultimately made a bad bargain, since D sold an asset worth $20,000 for merely $10,000. This does not necessarily mean that “P is getting something he had not paid for”, since presumably D provided some sort of explanation to the victim for D’s own imprudence at selling below the represented market value.

If we change figures to a more likely scenario, such that the price paid is $20,000, the value represented is $20,000, and the value received is $10,000, the American rule would give P damages of $10,000, to bring the value transferred from D to P to a total of $20,000. The orthodox rule in England and Canada would also give P $10,000, calculated under the ‘price paid minus value received’ formula. This congruence of the two approaches occurs because P was induced to pay a purchase price equal to what he was told the asset purchased was worth.

The difference between the two approaches emerges when we change the figures once again, making the price paid $20,000, the value represented $30,000, and the value received $5,000. The American “benefit of bargain” approach would give P damages of $25,000 whereas the orthodox rule would award only $15,000.

Thus in a situation where P has purchased an asset, only where the market value was represented to exceed the purchase price, and the value received is less than the purchase price, will the American expectation measure be greater than the orthodox ‘price paid minus value received’ measure.

Returning to our paradigm, it is difficult to see how a windfall could ensue where P has been tortuously induced to *part* with goods and services by accepting too low a price compared to the cost of performance. Under the orthodox rule, it is D who obtains ‘something for nothing’: the enduring enjoyment of the asset, with a subjective surplus benefit which presumably was the purpose of acquiring the asset or services,249 at the price of P’s out-of-pocket cost.

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248 Supra note 66.

Thus the fear of conferring a windfall on the victim who has been tortiously induced to enter a loss-making contract is exaggerated, if not unfounded altogether.

5.2.4 Economic efficiency

Finally, the proposed rule is consistent with the protective role which tort law has come to assume towards contract. The torts of deceit, and to a lesser degree negligent misstatement, were originally conceived to protect the plaintiff’s freedom of contract. The economic efficiency rationale for the law of contract assumes a level playing field, with equally informed parties bargaining on equal terms; where the contractual promise results from misinformation supplied by the promisee, the promisor’s breach may be excused. Tort law also seeks to protect the ‘equality’ of the bargaining positions of the parties by deterring improper or unconscionable conduct.

Granted that this does not go so far as to impose positive obligations to protect the other party; as Peter Cane notes,

The law’s concern here is not so much to ensure that contracting parties have sufficient information on which to base their economic choices: the basic rule is that mere failure to disclose relevant information is not tortious. Rather, the main aim is to make good the effects of the giving of inaccurate information which influences economic choices.

If one party seeks to protect its own economic interest by seeking information on which to base its choice and is provided with misinformation, then its decision is distorted. Contracts tortiously induced on false premises are economically wasteful, as they are performed at less than their true exchange value. It is inefficient to allocate the loss to the victims of the tortious practices, who (by the liability requirements of these torts) were entitled in law to rely upon the information provided to them.

Economists argue that tort law should foster economically efficient exchange values for transactions, to ensure that the market operates properly. While tort does not attempt to overcome the distortion created by the plaintiff’s unilateral mistake about the nature of the contract or the risk undertaken thereunder, or some other imbalance in power created by unequal possession of information, it will intervene where such a mistake is intentionally or negligently induced by another party, to protect the integrity and stability of the institution of contract itself.

250 See Pasley v. Freeman (1789) 3 Term Rep. 51, which reformed the tort of deceit to permit liability where the tort did not result in a contract.


252 Cane, Economic Interests, supra note at 167.

253 I am thus extending Jackman’s “facilitative institution” justification for expectation damages in contract [“Restitution for Wrongs”, supra note 231 at 319-21].
Legal economists tend to dwell on a fraudulently induced contract as being inefficient, because it is a coerced transfer of wealth to the defendant. The remedial objective is to channel resource allocation through the low transaction costs of the market, by making the tort worthless to the tortfeasor.254 As Posner caustically remarks, the law should not reward “the liar [who] makes a positive investment in manufacturing and disseminating misinformation”, which is completely wasted from a social standpoint.255 However, the same disruption of the economists’ free and voluntary bargain model occurs in cases of negligent misstatement, particularly under the ‘no transaction’ model.

The economic efficiency of imposing a duty to take reasonable care to ensure the accuracy of information exchanged by bargaining parties was expressly recognised by the Supreme Court of Canada in Edgeworth Construction Ltd. v. N.D. Lea & Associates, holding that if a tenderer for a construction project had to redo all the investigative work already conducted by the owner’s consultants, the price of tenders, and the ultimate cost of the project, would escalate to reflect the increased cost of the bidding process.256 If the contractor is deprived of its profits in performing the contract where it has reasonably relied on misinformation provided by the owner, this objective of minimizing transaction costs will be frustrated.

Redefining P’s thwarted profits in a fully performed contract as compensable reliance losses will make the tortfeasor shoulder the real market costs of the transaction, without depriving it of any subjective additional value or expectations it may attach to the benefit derived from the bargain.257

VI. Conclusion

Courts adjudicating civil fraud cases are fond of saying that the only question is what remedy will do complete justice,258 and that rule-based formulae for assessing fraud damages must be eschewed where they fall short of this goal.259 There seems no principled reason for negligence awards to fall short of this gold standard.

It has been submitted that at least where the misrepresentation has resulted in a fully or substantially executed contract, the misrepresentee’s expectations in performing it should in principle be protected by tort law as an actual, readily

255 Ibid. at 109-10.
quantifiable loss. I have sought to demonstrate that the orthodoxy should not be an ineluctable principle, as it results in under-compensation and under-deterrence, and so thwarts the objectives of tort law.

The orthodox school assumes that protection of expectations must be assigned to contract and only to contract. The devices which tort remedial law currently uses to compensate for lost expectations afford only sporadic, and often fortuitous, protection, while often straying into speculation. The orthodox approach, fearing to extend tort liability for pure economic loss into non-promissory territory, ignores the existence of the contract to which the tort gave birth.

The logic of the argument that a tort victim should not recover damages for lost profit from a contract it would never have entered into had the true facts been disclosed loses weight when placed in the balance against the social and economic costs of misrepresentations which induce a party to enter into and to perform a contract at great financial loss. Now that tort law has extended its domain into the commercial realm, it must recognize the realities of that world. Businesses engage in contracts in order to make a profit. In a credit economy, expectations of future gains become, for the purposes of trade, present values. The continuation of bank financing may well depend on maintenance of those profit margins as originally priced. It will not do for tort law to assume that it is making P whole by merely restoring to it the cost of performance.

Lord Reid claimed that "The life blood of the law is not logic but common sense". Sir Thomas Bingham M.R. has also reminded us of the "common sense which is supposed to reign" in the field of remedies for negligent misstatement. The Supreme Court of Canada has also called for the rationalisation of remedies in tort and contract. This impetus for pragmatic reform should re-examine the rules quantifying damages where actionable misrepresentations have induced contracts, to reflect commercial reality rather than rigid formalistic logic. The anomalies whereby the awards in contract and in tort are equal where the misrepresentation is relatively trivial, but significantly discrepant where the tort vitiates the very essence of the bargain, should be erased.

260 Even in sophisticated corporations which for accounting purposes allocate indirect costs such as head office overheads to specific contracts, the profit margins on those contracts may be used to keep the business enterprise alive.
261 Fuller and Perdue justified recovery of the expectancy interest in contract as it is an economic commodity and hence a property asset of the innocent party: "Reliance Interest in Contract Damages", supra note 215 at 59-60, 62-66.
262 R v. Smith (Roger) [1975] A.C. 476 at 500 (H.L.), quoted by Ormrod LJ in Esso Petroleum v. Mardon, supra note 5 at 830C.