MATHS FOR CONTRACT LAWYERS

1. Expectation Damages for Breach of Contract
2. Debt Claims
3. Accepted Repudiations
4. Unaccepted Repudiations
5. ‘Reliance’ Damages
6. Account of Profits
7. Efficient Breach

1. Expectation Damages for Breach of Contract

The normal remedy for a breach of contract is expectation damages – damages designed to put the victim of the breach in the position he or she would have been had the breach not occurred. Examples:

(1) A contracts to sing at B's opera house on Sunday for a fee of £25,000. On Saturday, B tells A her services are no longer required. A will be entitled to sue B for £25,000 in damages – the money she would have made had B not breached his contract with A by refusing to let her sing.

(2) A contracts to supply B with 10,000 widgets, at a price of £3 per widget. It will cost A £2 to make each widget. Before A has manufactured any of the widgets, B tells A that he no longer requires any widgets from A. A will be entitled to sue B for £10,000 in damages. Had B not breached the contract, A would have been paid £30,000 for the widgets that she supplied B – but it also would have cost her £20,000 to produce those widgets. So A would only have made a £10,000 profit from performing her contract with B, and consequently £10,000 in damages will be enough to put A in the position she would have been in had B not breached his contract with A.

(3) A contracts to supply B with 10,000 widgets, at a price of £3 per widget. A manufactures 7,000 of the widgets, at a cost of £2 per widget, when B contacts A to say that he no longer requires any widgets from A. (The price of widgets has collapsed since A and B made their deal and B can now obtain the widgets he wants for £1 per widget.) A will be entitled to sue B for £17,000 in damages. Had B not breached the contract, A would have been paid £30,000 for the widgets that she supplied B – but A would have also incurred a further £6,000 in expenses producing the remaining 3,000 widgets ordered by B. So had B not breached his contract with A, A would have made £30,000 and spent a further £6,000. So A would have made a profit of £24,000 had B not breached his contract with A. But B's breach means that A now has 7,000 widgets that she is free to sell to someone else for £7,000 (at £1 per widget). So B just has to pay A £17,000 in damages to put A in the position she would have been in had B not breached his contract with A.

(4) A contracts to supply B with 10,000 widgets, at a price of £3 per widget. Before A has manufactured any widgets, she discovers that manufacturing problems mean that it will cost her £4 to produce each widget ordered by B – with the result that A will lose £10,000 if she performs her contract with B. Much to A's relief, B contacts A to say that he no longer requires any widgets from A. A will not be entitled to sue B for anything in damages. Had B not breached the contract, A would have been paid £30,000 for the widgets that she supplied B – but A would have paid £40,000 to produce them, making a loss of £10,000 in all. So B does not have to pay A anything in damages to put her in the position she would have been in had B not breached the contract; B's breach has actually made A better off than she would have been had the contract been properly performed.

(5) A contracts to supply B with 10,000 widgets, at a price of £3 per widget. B enters into a forward contract with C under which B undertakes to supply C with 10,000 widgets, at a price of £4 per widget. B intends to use the widgets supplied to him by A to perform his contract with C. A tells B that she will not be able to perform her contract with him. B is able to obtain an alternative supply of 10,000 widgets at a price of £3.80 per widget. B will be entitled to sue A for £8,000 in damages. Had A not breached her contract with B, B

would have made £40,000 supplying C with 10,000 widgets – but he would also have had to pay A £30,000 for the widgets supplied by A. So B would have made a profit of £10,000. But now B can only make a profit of £2,000 on his contract with C, by buying 10,000 widgets at £3.80 per widget, and selling them on to C at £4,000 per widget – a profit of 20 p per widget, and £2,000 on the deal with C. In order to put B in the position he would have been in had A performed his contract with B, A needs to pay B £8,000 in damages, thus allowing B to end up with £10,000 profit: the £2,000 profit on the deal with C plus £8,000 in damages from A.

(6) A contracts to supply B with 10,000 widgets, at a price of £3 per widget. B enters into a forward contract with C under which B undertakes to supply C with 10,000 widgets, at a price of £4 per widget. B intends to use the widgets supplied to him by A to perform his contract with C. A tells B that she will not be able to perform her contract with him. B is able to obtain an alternative supply of 10,000 widgets at a price of £5 per widget. (The market for widgets has gone up since A and B and C entered into their respective contracts.) A is liable to pay B £20,000 in damages. Had A not breached her contract with B, B would have made a £10,000 profit supplying A's widgets to C. But now that A has breached her contract with B, B stands to make a £10,000 loss from performing his contract with C – he will have to pay £50,000 to obtain the widgets needed to perform his contract with C, and will only be paid by C £40,000 for those widgets. So in order to turn B's £10,000 loss into a £10,000 profit, A needs to pay B £20,000 in damages. Even if B breaches his contract with C, B will still make a £10,000 loss on his contract with C, as C will sue him for damages equal to the cost of obtaining 10,000 widgets from elsewhere (£50,000) minus the money C would have had to pay B for those widgets (£40,000) – so £10,000 in damages. So whether B performs or breaches his contract with C, he will still lose £10,000 on his contract with C, and will lose the further £10,000 profit that he would have made performing his contract with C had A performed her contract with B. So, whatever B does, A will be liable to pay B £20,000 in damages.

2. Debt Claims

Claims for a debt are different from claims for damages. Debt claims are for money that was agreed to be paid under a contract provided certain conditions were fulfilled. Examples:

(1) A contracts to sing at B's opera house on Sunday for a fee of £25,000. A does so, but B is aggrieved that A does not sing any encores and refuses to pay A for her performance. A will be entitled to bring a debt claim against B for £25,000. She has 'substantially performed' her obligations under her contract with B. If her contract did stipulate that she was supposed to sing one or more encores, then it is up to B to sue A separately for a breach of contract, and recover damages designed to put B in the position he would have been in had A sung the encores. But B still owes A £25,000.

(2) A contracts to supply B with 10,000 widgets, at a price of £3 per widget. It will cost A £2 to manufacture each widget. A manufactures the widgets and supplies them to B's warehouse. B contacts A to say that he no longer wants the widgets. (The market for widgets has collapsed since B entered into his contract with A, and B can now get widgets for £1 per widget.) B invites A to pick her widgets up from B's warehouse. A will be entitled to bring a debt claim against B for £30,000 – the agreed price for the widgets that A has supplied to B. If A were to sue B for damages for refusing to pay the agreed sum, A

would only be able to sue B for £20,000, on the basis that had B properly performed the contract A would have been paid £30,000, but as it is she can still sell her widgets to someone else for £10,000 (at a price of £1 per widget) – so B only needs to pay A £20,000 to put A in the position she would have been in had B performed his contract with A. Bringing the debt claim is easier for A – she can just make an application for summary judgment against B in court and get her money that way, instead of going to the trouble of picking up the widgets from B's warehouse, finding someone else to buy them, and then suing B for damages to bring her up to the position she would have been in had B properly performed the contract.

3. Accepted Repudiations

In the case where A has entered into a contract with B, and B has refused to perform her side of the bargain, A can then terminate the contract and sue B for damages. However, that is not the only remedy that A might be able to go for. If A did some work under the contract before it was terminated for B's repudiation, A might be able to sue for a reasonable sum (a *quantum meruit* (= 'as much as he deserves') for the work she did under the contract. And if A paid B some money in advance, in part payment for what B was going to do for A under the contract, then A will be entitled to sue for that money back – so long, though, as A has suffered what is called a *total failure of consideration*, where A has not received any part of what he bargained for under her contract with B. Examples:

(1) A contracts to supply B with 10,000 widgets, at a price of £3 per widget. A has manufactured 8,000 widgets and has discovered that due to manufacturing difficulties that producing the widgets it costing him £5 per widget. In the meantime, the market for widgets has collapsed, with the result that the widgets that B wants can now be purchased for £1 per widget. While A is contemplating simply purchasing the remaining 2,000 widgets that she needs to fulfil B's order, at a cost of £2,000, A gets a call from B telling her that he no longer requires any widgets from her. A accepts B's repudiation of his contract with her. If A were to sue B for damages, she would get £20,000. This is because had B not breached his contract with A, A would have been paid £30,000, but would have had to pay £2,000 to obtain the remaining 2,000 widgets that she needs to complete B's order – so she would have made a net profit of £28,000. But B's breach also means that A now has 8,000 widgets in her hands that she is now free to sell on the open market, and for which she can get £8,000. So B only needs to pay A £20,000 to put A in the position she would have been in had B not breached his contract with her – that of having £28,000 in her bank account. But as an alternative remedy, A might be able to sue for a reasonable sum for the work she has done producing the widgets ordered by B. This would probably come to £40,000 (the cost of producing 8,000 widgets at £5 per widget) minus the £8,000 that A could now obtain on the open market for the widgets she has produced – that is, £32,000. This is more than A could get from B if A were to sue B for damages, so it might make sense for A to sue B here for a *quantum meruit*.

(2) A contracts to supply B with 10,000 widgets, at a price of £3 per widget. A has manufactured 2,000 and has discovered that due to manufacturing difficulties that producing the widgets it is costing him £5 per widget. In the meantime, the market for widgets has collapsed, with the result that the widgets that B wants can now be purchased for £1 per widget. While A is contemplating simply purchasing the remaining 8,000 widgets that she needs to fulfil B's order, at a cost of £8,000, A gets a call from B telling

her that he no longer requires any widgets from her. A accepts B's repudiation of his contract with her. If A were to sue B for damages, she would get £20,000 (can you see why? – it is the same figure as in example (2), but why?). As an alternative remedy, A might be able to sue for a reasonable sum for the work she has done producing the widgets ordered by B. This would probably come to £8,000 (can you see why?). Given that £8,000 is much less than £20,000, it would be in A's interests simply to sue B for damages.

(3) A contracts to sing at B's opera house on Sunday, for a fee of £30,000. B pays A half of her fee (£15,000) upfront. Tickets to hear A sing sell extremely slowly, with the result that only 100 tickets (at a price of £100 per ticket) have been sold by Saturday night. (B's opera house has enough room for 800 people.) A hears about the slow sales and indignantly protests to B that she will not sing to just 100 people. B accepts A's repudiation of her contract with B. If B sues A for damages, he will not recover anything. This is because now that A is no longer going to sing, B will have to refund the 100 ticket holders the £100 they each paid for a ticket to hear A sing (because they have suffered a total failure of consideration on their contracts with B). So had A properly performed her contract, B would not have had to pay out £10,000 to the disappointed ticket holders. A is in principle liable to compensate B for this loss – but if A had properly performed, B would also have had to pay out to her the remainder of her fee, which comes to £15,000. So B has not in fact suffered any net loss as a result of A's breach of contract – he will have to pay £10,000 to the disappointed ticket holders, but will save the £15,000 he would otherwise have had to pay A. So suing A for damages will be pointless. A much better remedy for B will be to sue A to recover the money he paid upfront for her to sing at his opera house, on the ground that he has suffered a total failure of consideration in respect of that payment – he hasn't got anything for which he was paying when he paid that money. This will allow him to sue A for £15,000.

(4) A contracts to sing at B's opera house on Sunday, for a fee of £30,000. B pays A half of her fee (£15,000) upfront. Tickets to hear A sing sell well, but do not sell out: by Saturday 500 of the 800 available tickets have been sold, at a price of £100 per ticket. A is affronted that her performance is not a sell-out and tells B that she will not perform to a virtually half empty opera house. B accepts A's repudiation of the contract. If B sues A for damages, he will recover £35,000. This is because had A properly performed her contract, B would not have been liable (as he is now) to refund his 500 customers the £50,000 they collectively paid to hear A sing. But at the same time, had A properly performed, B would have been liable to pay A the remaining £15,000 owed to her for her fee. So had A properly performed, B would have had to pay out £15,000 – but now that A is not performing, B has to pay out £50,000. The difference is £35,000, and that is how much A will have to pay B in damages to put him in the position he would have been had she properly performed her contract with B. The alternative remedy of B's suing A for his money back on basis that he suffered a total failure of consideration in respect of that payment will only give B £15,000 – the half of A's fee that B paid A upfront. So it will be in B's interests here to bring a claim for damages against A, rather than a claim for money back.

In situations (1) and (3), the victim of the breach of contract has made a bad bargain. In situation (1), the ability to bring a claim for a reasonable sum allows A to break even on her contract with B – she spends £40,000 on manufacturing 8,000 widgets, and is able to recover that sum by suing B for a reasonable sum of £32,000 and by selling the 8,000 widgets on the open market for £8,000. Had the contract been properly performed, A would have lost

£12,000, as she would have spent £40,000 on manufacturing 8,000 widgets and £2,000 on sourcing the remaining 2,000 widgets, and only obtained £30,000 under her contract with B. In situation (3), the ability to bring a claim for money back actually allows B to make £5,000 profit on a deal that, had it been properly performed, would have lost him £20,000. This is because if B can sue A for £15,000 back, he can then pay off the ticket holders who were expecting to hear A sing by giving them £10,000, leaving £5,000 in his pocket. Contrast the position if A had sung at B's opera house: B would have been liable to pay A her £30,000 fee in full and would have only made £10,000 from people paying to hear A sing.

It is generally the case that the victim of a breach of contract will only be interested in bringing a claim for a reasonable sum for work done/goods supplied or a claim for money back in a situation where she has made a bad bargain. As situations (2) and (4) show, if the victim of a breach stands to make a profit from a contract being properly performed, it will be in her interests to sue the contract breaker for damages, rather than seeking to bring a claim for a reasonable sum or for her money back. In situation (2), A's contract with B has not yet turned bad – A has not yet manufactured so many widgets at £5 per widget that she can't still make a profit on her contract with B. She has spent £10,000 on producing 2,000 widgets, but can now obtain the remaining widgets she needs to fulfil her contract with B for £8,000 (at £1 per widget). So she will still make £12,000 on her contract if it is properly performed – maybe not as much as she hoped to make when she contracted with B, but still a profit. In this situation, it is not in A's interests to bring a claim for a reasonable sum for the widgets she has already manufactured: she should sue for damages in respect of the money she would have made had the contract been properly performed. In situation (4), A's contract with B is good for B – 500 people want to hear A sing at £100 each, when he has agreed to pay A £30,000 for singing: a profit of £20,000. In this situation, it makes no sense for B to try to sue A – when A repudiates her contract with B – to get back the £15,000 half fee that B paid A upfront. B should instead sue A for £35,000 damages which will leave him (having already paid A £15,000 upfront) £20,000 up on his deal with A – which is the profit he would have made had A properly performed her contract with B.

Some would question why the law should assist the victims of breaches of contract to escape the consequences of a bad bargain by allowing them to bring claims for a reasonable sum or for their money back. Others argue that these claims are brought under an independent area of law – the law on unjust enrichment, or the law of restitution – and that area of law is indifferent to whether it operates in a way that allows people to escape the consequences of making a foolish choice: it is merely concerned to allow people to recover benefits that they have conferred on other people when the recipients of those benefits would be unjustly enriched if they were allowed to retain those benefits.

4. Unaccepted Repudiations

In the previous section, we were concerned with situations where the victim of a breach of contract has terminated the contract in response to the other party repudiating that contract, and considered what remedies would be available to the victim in that situation. But what if the victim refuses to terminate the contract and insists on continuing to perform it? Sometimes this won't be an option. For example, if A contracts to sing for B at B's opera house on Sunday, and B then tells A that her services are no longer required, A will have no choice but to accept B's repudiation: she can hardly push her way onto the stage of B's opera house on Sunday and start singing. But if A contracts to supply B with 10,000 widgets and B

then tells A that he no longer requires A's widgets, A could insist on delivering the widgets at the time and place stipulated in the contract: she does not require B's co-operation to perform her side of her contract with B. So what happens if A insists on going ahead and performing her side of her contract with B? The rule is that A will be entitled to bring a claim in debt for the money B promised to pay her for proper performance *so long as she had a legitimate interest in carrying on with the contract when B repudiated it*. If she did not, then A is confined to suing for whatever she could have sued B for had she accepted B's repudiation of his contract with her. For example:

> (1) A contracts to supply B with 10,000 widgets, at a price of £3 per widget. A manufactures 3,000 widgets, and doing so costs A £2 per widget. B then informs A that he will no longer require her widgets. (The market price for widgets has suddenly dropped and B can obtain the same widgets elsewhere for just £2 a widget.) A insists on continuing with performance of her contract with B, and spends £14,000 manufacturing the remaining 7,000 widgets needed to fulfil B's order. A drops the 10,000 widgets off at B's warehouse, together with an invoice for £30,000. *If* A had a legitimate interest in carrying on performing her contract with B after B had repudiated it, then she will be able to sue B in debt for £30,000. *However*, if A did *not* have a legitimate interest in carrying on with the contract, she will be confined to suing B for whatever she could have sued B for had she accepted B's repudiation. If A had accepted B's repudiation she could have sued B for £10,000 in damages (which equals the £30,000 A would have obtained from proper performance, minus the £14,000 she would have had to spend producing the remaining 7,000 widgets needed to fulfil B's order, and minus the £6,000 she could make by selling the 3,000 widgets that she had already produced for B and which B's repudiation meant she could now sell on the open market). (The alternative remedy, of suing B for a reasonable sum for the work already done producing widgets for B would have been worthless, as A could have recovered as much as she had spent producing those widgets by selling them on the open market.) So if A did *not* have a legitimate interest in continuing to perform her contract with B, she would be confined to suing B for £10,000. But this would mean that A would make a £10,000 loss on her contract with B. The most she could sue B for would be £10,000 in damages, when she spent £6,000 producing the first 3,000 widgets under her contract with B, and £14,000 producing the remaining 7,000 widgets – so £20,000 in all. So the inquiry into whether A had a legitimate interest in carrying on with her contract with B will make a huge difference to A. If the court finds that she had a legitimate interest, then she makes a £10,000 profit on her contract with B because she can sue him in debt for £30,000, having spent £20,000 performing the contract. If the court finds that she did not have a legitimate interest, then she will make a £10,000 loss on her contract with B because she can only sue him for £10,000 in damages, having spent £20,000 performing the contract.

So continuing to perform a contract which has been repudiated by the other party is a dangerous game: you can end up turning what should have been a profitable contract into a bad contract for you. So why would anyone play this game? Why wouldn't you, if someone repudiated a contract to which you were party, *always* say, 'Okay – I accept your repudiation, and will see you in court.' There are three reasons:

(i) Actions for debt are easier to bring than claims for damages, and some people prefer the certainty of an action for debt ('You owe me £30,000!') to the imponderables of an action for damages ('You breached your contract with me and I have suffered the following heads of loss as I will now go on to specify and prove!').

(ii) Where a repudiation has been accepted, the damages payable to the victim of the breach will be reduced to take account of the value of time and labour and money the victim of the breach would have spent on performing the contract and some people don't particularly value their time and labour. For example:

> (2) A is an unemployed musician. B, a famous singer, contracts to pay A £5,000 to write a song that B will sing at the wedding of B's daughter. B subsequently falls out with his daughter over a naked photo shoot she did for *Hot Stuff* magazine a month before the wedding, and tells A that he won't sing at his daughter's wedding. A insists on pressing ahead with writing the song and seeks to claim the £5,000 she argues B owes her for writing the song. In this situation, A is probably unwilling to accept B's repudiation because she has literally nothing else to do with the time she will spend on writing a song for B. So she would rather spend that time earning £5,000 from B rather than accepting B's repudiation and suing B for damages, which would come to £5,000 minus the (probably substantial) value the courts would put on A's time and labour in writing the song.

(iii) There may be situations where a party's continuing to perform a contract will result in that party obtaining certain intangible and hard to value benefits which would be unlikely to be properly reflected in any damages award that that party might obtain in the event that she accepted the other's party's repudiation of that contract. For example:

> (3) A owns a plane which he uses to write messages in the sky. B contracts with A to fly over Old Trafford on a day when B and his girlfriend, Clare, will be sitting together watching Manchester United play, and write in the sky above Old Trafford, 'Will you marry me Clare?' But later on B gets cold feet and tells A to forget the idea. A refuses and writes the message in the sky over Old Trafford at the appointed date and time. In this situation, A is insisting on continuing with her contract with B because suing B for damages won't adequately compensate her for the loss of the possible commercial benefits to her from performing her contract with C – in particular, the business for A that might be drummed up as a result of the publicity B's proposal of marriage will get. This would be very hard for a court to value, and could consequently be severely undercompensated were A meekly to accept B's repudiation and simply sue for damages.

It seems likely that is only where someone has refused to accept a repudiation of a contract for reason (iii) that they will be held to have had a legitimate interest in continuing with the contract. Continuing with a contract simply because it struck you as being the easiest way of making money off the other party to the contract will not count as a legitimate interest in carrying on, and you may well end up losing a lot of money as a result. But not always:

> (4) A contracts with B that she will paint his portrait for a fee of £50,000. B plans to present the portrait to his wife for her birthday. After ten sittings, A thinks that she has gotten enough material together to finish the portrait. But then B discovers that his wife has been having an affair, and he tells A to forget about the portrait. A refuses and produces the final portrait and invoices B for £50,000. Her claim in debt for £50,000 is likely to be turned down, as completion of the portrait was not likely to result in her obtaining certain hard to value benefits: given the circumstances, B was probably going to burn the portrait when it was finished, or put it in an attic somewhere. So A would be confined to the remedy she would have obtained had she accepted B's repudiation.

Assuming that the courts valued the time and labour needed to produce the portrait at £35,000 (giving A a profit of £15,000 on producing the portrait) and assuming that 90% of that time and labour had already been expended by the time of B's repudiation, the damages payable to A had she accepted B's repudiation would have come to £46,500. (This is because had the contract been properly performed, A would have been paid £50,000 by B, but would have had to expend a further £3,500 in time and labour to earn that £50,000. Note that the alternative remedy, of suing B for a reasonable sum for the work she had done already on the portrait, would have just given her 90% of £35,000 (that is, £31,500), which is not as good as £46,500.) So in the situation where A has finished the portrait, she will be confined to suing B for £46,500. This will give her a profit on the portrait of £11,500 (because she will be able to sue B for £46,500, but the value of her time and labour came to £35,000). This is not as good as the profit she would have made had she stopped when B told her to, which would have been £15,000 (the damages payable at that point (£46,500) minus the value of the time and labour that she had put into the portrait up until that point (£31,500)), but it's certainly not disastrous. A has simply wasted the last 10% of the time and labour that she put into finishing the portrait.

5. 'Reliance' damages

'Reliance' damages are designed to put the victim of a breach of contract in the position he or she was in before the contract was entered into. They are *not* claimable in English law. You might be able to get what *look like* 'reliance damages' in a contractual context in the following three situations:

(i) Where A is induced into entering into a contract with B as a result of a misrepresentation made by B without reasonable grounds for believing in its truth, then A will be able to sue B for damages under s 2(1) of the Misrepresentation Act 1967 to compensate her for any losses suffered by her as a result of contracting with B.

(ii) Where A terminates a contract with B because of a repudiatory breach by B, and sues either for a reasonable sum for work already done by A under the contract, or to recover money paid by A to B under the contract.

(iii) Where A is the victim of a breach of contract committed by B, and in assessing the expectation damages payable to A, designed to put A in the position she would have been in had her contract with B been properly performed, the courts look at how much money A spent in the expectation that her contract with B would be properly performed in order to get some idea of how much A expected to gain as a result of her contract with B being properly performed.

It might be okay to call the damages in (i) 'reliance damages' – it would certainly be wrong to describe B's liability to A in (ii) or (iii) as being a liability to pay A 'reliance damages'. Examples of (iii) are:

(1) A hires B to advertise A's new restaurant. A pays B £10,000 to place advertisements in a range of different media, and spends a further £15,000 on a sophisticated booking system and booking clerk to field the range of calls for reservations that A expects the advertisements to trigger. B fails to place any advertisements at all for A's restaurants. While it is impossible to tell how much money A would have made had B properly

performed the contract, the fact that A was willing to spend £25,000 in anticipation of B's advertisements bringing new business to the restaurant allows us to think that A would have made at least £25,000 had B performed the contract properly. So A might be awarded at least £25,000 in damages against B.

(2) A buys a vacant lot for £100,000 and builds a restaurant on the site; construction of the restaurant costs a further £200,000. A then hires a chef, B, to cook in the restaurant, and subsequently hires various other staff to attend to the customers and helping B with the cooking. The restaurant has a 'soft opening' in January, intended to allow the restaurant to iron out any teething problems before opening properly in March. One evening, B is observed by a customer urinating into a sauce that he is preparing. News of this hits the media, and A's restaurant goes out of business for lack of custom shortly afterwards. A sues B for breach of contract. It is impossible to tell how successful A's restaurant would have been had B properly performed his contract with A, but the amount of money A spent on the restaurant and in hiring staff allows us to make an estimate that it would have made at least £400,000 over its lifetime. (Note that a lot of the expenditures that we are taking into account in coming to that figure were incurred before A hired a chef – so in awarding A £400,000 we cannot be said to be putting A back in the position she was in before she entered into a contract with B.)

6. Account of profits

In situations where A is not able to sue B for a substantial sum by way of normal contractual damages, it might be possible for A to sue B for any profits that B made by breaching his contract with A. This remedy is known as an 'account of profits', though some prefer the term 'restitutionary damages' (not to be confused with restitutionary actions for a reasonable sum for work done under a contract that has been terminated, or to recover money that was paid under a contract that has been terminated – neither of which can be described as actions for 'damages'). As to when the victim of a breach of contract can sue for an account of profit, the conditions for such an award being made available were set out by the House of Lords in *Attorney-General* v *Blake*: in a case where B has breached a contract with A and made some kind of gain as a result, A may be entitled to sue B for an award designed to strip B of that gain if: (1) ordinary damages would be an 'inadequate' remedy for B's breach of contract (which is generally read as meaning that ordinary damages wouldn't give A anything much); and (2) A has a legitimate interest in seeking to prevent the kind of behaviour that resulted in B's making his gain. Examples where these conditions may be satisfied are:

(1) A, a film star, employs B to work as his children's nanny. B's contract of employment specifies that she is not to disclose any information that she learns in the course of working for A to anyone. After B leaves A's employ, she writes a book about her time with A and his family. A suffers no loss as a result of B's breach; indeed, the portrayal of A and his family is so flattering that A receives a major career boost as a result of the publication of the book. However, A may be entitled to sue B for an account of profits as ordinary damages would give A nothing, and A has a legitimate interest in trying to prevent people like B talking about his home life.

(2) In return for a fixed monthly fee that B pays A, A allows B the exclusive right to sell his products in a particular geographical location. B's contract with A specifies that B is not sell A's products for more than the prices set out in B's contract, so as to ensure that

A's products remain competitively priced. B breaches this term, and routinely sells A's goods for more than the prices set out in his contract with A. It is not clear that B's breach has caused A any harm, so A might not be able to recover very much from B way of normal damages; but A might well be able to recover damages from B in respect of the money made by B as a result of his breach as he has a legitimate interest in preventing B pricing his goods out of the market.

(3) B – a famous rock star – invited A – an equally famous rock star – to record some songs with him in B's recording studio. A turned up to the studio drunk and the session was a shambolic disaster. After A sobered up, she begged B never to allow the tapes of the session to see the light of day. B replied, 'Don't worry – they won't: so long as you agree to come on and play one song with me at my concert at the end of the month.' A does so. B has now died of an overdose, and B's estate released the tracks recorded with A as part of a 'Bootleg Album' of unreleased recordings made by B before he died. It is not clear that B's estate's breach of its agreement with A has caused B any harm, so A might not recover very much by way of normal damages were she to sue B's estate for breach of contract. However, as A has a legitimate interest in preventing recordings that portray her in an unflattering light being made widely available, she might be able to sue for an account of profits under the *Blake* criteria.

It is not difficult to see that the remedy of an account of profits might be available under *Blake* in all these situations. What is difficult to know – and this is where mathematics becomes relevant – is *how much* A will be allowed to sue B for in these situations.

In *Blake* it was assumed that the remedy of an account of profits would work to strip a contract breaker of all the gains that he made as a result of committing a breach of contract. So in (1), that would come to all the monies made by B as a result of her book (as there would be no book if B had not breached her contract). In (2), that would be the difference between the prices actually charged by B for A's goods and the prices B was supposed to charge for A's goods. And in (3), that would be the gains made by B's estate that it would not have made had it left the tracks recorded by B with A off the 'Bootleg Album'. (That last sum is very hard to determine – it requires the courts to estimate how many copies of the 'Bootleg Album' would have been sold in the absence of the tracks recorded by B with A.)

However, in the later case of *Experience Hendrix* (on which (3) is based) it was made clear that in a case where the *Blake* criteria were satisfied, the courts might not award the victim of a breach of contract a full-blown account of profits, but might instead allow the victim of the breach to sue for a *reasonable sum* for the contract breaker's being allowed to do what he did. That would mean that in (3), the courts would not try to assess how much money had been made by B's estate as a result of including the tracks recorded with A on B's 'Bootleg Album' but would simply ask what would be a reasonable sum for A to charge B's estate for using those tracks as part of the album? Similarly, in (1) the question would be – what would be a reasonable sum for A to charge B for her to be allowed to go ahead and disclose details of A's family life in her book? And in (2) the question would be – how much could A reasonably charge B for being allowed to decide for himself what prices at which to sell A's products.

What no one knows is which approach will be adopted, and when, in situations where the *Blake* criteria are satisfied. One suggestion is that where the breach of contract was deliberate, then the courts will allow the victim of the breach to sue for the more onerous full

blown account of profits in order to punish the contract breaker for his behaviour. That would mean a full blown account of profits would be available in all three of the cases set out above. However, that suggestion is not really reconcilable with the cases, as in *Experience Hendrix* the breach seemed pretty deliberate, but only a reasonable sum was awarded. Another suggestion is that a reasonable sum should be awarded where at least some of the profits made by the contract breaker are attributable to the contract breaker's own efforts – the idea being that awarding a full blown account of profits in such a case would allow the victim of the breach to take advantage, unfairly, of the work done by the contract breaker to generate those profits. This would mean awarding a reasonable sum in (1) (where B must have done a lot of work writing the book) and (3) (where a lot of work by B's estate went into producing and marketing the 'Bootleg Album') but maybe not (2) (assuming that A's products just sell themselves). Again, this suggestion is not really reconcilable with the cases, as in *Blake* a full-blown account of profits was ordered, even though the case was analogous to (1).

7. Efficient Breach

Some contract lawyers would say that the idea of awarding an account of profits against a contract breaker is always unacceptable; the idea being that breaches of contract are sometimes good things, and stripping contract breakers of any of the gains they might make from a breach of contract might discourage them from committing a breach of contract when doing so might actually be desirable.

The idea that breaking a contract might be a good thing to do comes from the 'law and economics' movement, which argues that the rules of contract law – and the law generally – are finely tuned in order to promote the maximisation of wealth. Wealth is maximised when resources are placed in the hands of those who are able to make the most productive use of them. As we cannot determine this directly, we do so indirectly by assuming that if an asset is in the hands of someone who is ready and willing to pay the most money for it, then it is in the hands of the person who is able to make the most productive use of that asset. (The idea being that if someone else could make more productive use of that asset, then they would be ready and willing to pay more for that asset than its current owner and would therefore be able to persuade the current owner to sell the asset to them.) So – we can confidently assume that wealth is maximised when resources are placed in the hands of those who are ready and willing to pay the most for those assets.

Suppose, then, that A agrees to supply B with 10,000 widgets, at a price of £3 per widget. B plans to sell the widgets on to C once he gets them from A at a price of £5 per widget. So B was ready and willing to pay A anything up to £5 per widget, as at any price below £5 per widget, he would have been able to make a profit selling the widgets onto C. But B ended up agreeing to pay A £3 per widget. (The difference between what B was ready and willing to pay A for the widgets – up to £5 – and what B actually has ended up agreeing to pay A for the widgets is known by economists as B's 'consumer surplus'; a concept dealt with elsewhere on mcbridesguides.) Now suppose that D is urgently in need of widgets, and offers A £6 for the widgets that she is manufacturing to fulfil B's order. A concern for wealth maximisation would lead us to think that A should breach her contract with B and supply her 10,000 widgets to D instead. The reason is that D is ready and willing to pay more for A's widgets (up to £6) than B is (up to £5). So D 'values' the widgets more, and wealth will come closer to being maximised if they end up in D's hands than B's. So from the point of view of wealth maximisation, it would be a good thing if A breached her contract with B and gave the

10,000 widgets to D instead. Breach would be 'efficient', in the terminology used by specialists in law and economics.

The clever part of this theory is that the rules governing what remedies will be available to B, as the victim of a breach of contract, do seem to encourage A to breach her contract with B if and only if it would be 'efficient' to do so. B won't be able to compel A to hand the widgets over to him: there is no specific performance here. Instead, B will be confined to suing A for compensatory damages. Assuming that B cannot obtain any widgets elsewhere, those damages will come to £2 per widget: the difference between what B would have had to pay A for the widgets had they been delivered, and what B would have made had she been able to sell those widgets onto C. By making A pay B damages of £2 per widget, we guarantee that A will only breach her contract with B if it would be 'efficient' to do so. For example, suppose that D offered A £4 per widget for the 10,000 widgets she is manufacturing to fulfil B's order. This is a whole £1 per widget more than A could get from B, so one would think that A should jump at D's offer. But A has to think not about what she would get from B if she properly performed her contract with B, but what she will have to pay B if she breaches her contract with B. And what she will have to pay B will reflect, not what B agreed to pay A for her widgets, but what B would have been ready and willing to pay A given the use she is going to put the widgets too. Given that B was planning to sell the widgets onto C when they were supplied by A, at a price of £5 per widget, A will be held liable to pay B damages equal to £2 per widget if she breaches her contract with B. So D's offer of £4 per widget will not be enough to compensate A for the cost of having to pay damages to B. For every extra pound that she makes by supplying D – as compared with the £3 per widget she would have made supplying B – A will have to pay B £2, to compensate B for the loss of profit that he would have made and A performed her contract with B. So if D only offers A £4 per widget, A's response to D will be 'Thanks, but no thanks'. From the point of view of wealth maximisation, this is the right result. If D is only ready and willing to pay £4 per widget, then he does not value the widgets more than B, who was ready and willing to pay £5 per widget. It is only if D offers A more than £5 per widget that we should want A to breach her contract, and – amazingly – it is only if D offers more than £5 per widget that A will have an incentive to breach her contract with B, given the liabilities she will incur as a result of breaching that contract.

Of course, if B were allowed to sue A for the profits she made by breaching her contract with B, then this carefully calibrated scheme for encouraging A to breach her contract if and only if D could come up with a high enough offer to make it worth A's while to breach would be completely wrecked: whatever offer D came up with would never be enough to encourage A to breach, as A would never be allowed to keep the money she made from breaching her contract with D. That's why adherents to the school of law and economics are so opposed to 'account of profits' as a remedy for breach of contract, and perhaps why Lord Nicholls in *Blake* went out of his way to say that an account of profits would not be a remedy in the kind of situation we have just been considering.

In light of the above, it's no wonder so many people are seduced into thinking that contract law does indeed seek to promote the maximisation of wealth. But before we get suckered into thinking the same way, consider these points:

(1) If the law is so concerned with wealth maximisation and recognises that it might be 'efficient' in certain circumstances for someone to breach a contract, why is it a tort to induce someone to commit a breach of contract? And why might punitive damages be available

against someone who deliberately induces someone else to commit a breach of contract with a view to making a gain for himself?

(2) Most contractual duties are duties to pay someone else money, and it is not clear how a breach of that kind of duty could be efficient. Consider, for example, the insurance contract in the Canadian case of *Whiten* v *Pilot Insurance Co Ltd* (2002). The claimant's house burned down, and the defendant insurance company was liable to indemnify her against the loss of her house. The insurance company tried to weasel out of paying her, putting pressure on its investigators to say that the house had been deliberately burned down. (Their first investigator refused to say this and was fired; the most the second investigator was prepared to say was that it couldn't be ruled out that the fire had started accidentally, but that the claimant had stood by and allowed the fire to take hold of the house before calling for help!) The Canadian Supreme Court held the insurance company liable under the insurance company, and awarded punitive damages against it for good measure to teach it a lesson about not trying to get out of fulfilling its obligations under its insurance contracts. It is not clear how breaching the contract in *Whiten* could ever have been 'efficient' – and if it wasn't, that means that breaches of contracts to pay another money (which means most breaches of contract) can never be 'efficient'.

(3) Most devastatingly, Ronald Dworkin has questioned why we should be interested in wealth maximisation at all. (See Dworkin, 'Is wealth a value?' (1980) 9 Journal of Legal Studies 191.) It seems to be simply not true that resources should be placed in the hands of those who are *ready and willing* to pay the most for them. For example, suppose we have a bowl of rice. Two people are interested in having this bowl of rice. One, a poor, starving individual who is ready and willing to pay a fraction of a cent for the bowl of rice as that is all he can afford to pay for it. The other is Bill Gates, who would like a bowl of rice to go with his Chinese food – he is ready and willing to pay $10 for the bowl of rice. From the point of view of wealth maximisation, the bowl of rice should go to Bill Gates. But that is a morally repulsive conclusion.